WHY SPACS: AN APOLOGIA

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Special purpose acquisition companies (SPACs) dominated the initial public offering (IPO) market in recent years, but the Securities and Exchange Commission (SEC) has proposed rules that have chilled the SPAC market and, if made final, will likely strangle it completely. It is time to examine what, if anything, SPACs offer the capital markets.

Most commentators and regulators view SPACs as a mere regulatory sleight of hand. This Article focuses on SPACs' fundamental—but overlooked—innovation. Traditional securities law views average investors as prone to hysteria, and therefore relegates them to investment in public companies, reserving investment in private firms for the wealthy. The traditional securities law regime thus has the effect of preventing the general public from investing in private companies until after more wealthy investors have had their turn. But SPACs allow the public to trade based on information about a still-private company. Allowing free trading of this information is a radical departure from the basic structure and original purposes of U.S. securities law.

SPACs thus challenge securities law at its core. We use an original empirical dataset to argue that their success—or, to be precise, the success of some of them—is evidence that securities law may be overly paternalistic in its attitude toward the general public. Our data provide evidence that, as long as the SEC implements reforms that realign shareholders' interests with those of SPAC managers, SPACs can offer a valuable new opportunity in the markets.

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INTRODUCTION

Special purpose acquisition companies (SPACs) offer an alternative path for private companies seeking to go public that largely avoids the traditional investment-bank-mediated IPO. SPACs exploded in popularity in the past few years, to such a degree that they made up 60% of IPOs in 2020 and 66% in 2021.[1] Celebrities from Colin Kaepernick to Jay-Z launched SPACs,[2] but perhaps the most feverish attention came in October 2020, when a SPAC called Digital World Acquisition Corp (DWAC) announced plans to acquire Trump Media & Technology Group (TMTG), a new social-media company headed by former president Donald Trump.

Then, on March 30, 2022, the Securities and Exchange Commission (SEC) proposed rules that ground the burgeoning SPAC market to a halt by imposing IPO-like constraints on the private companies seeking to go public.[3] If the SEC's proposed rules become final, they will likely choke the market for SPACs out completely.

In light of these developments, we believe it is time to examine what the SPAC phenomenon has meant for the capital markets and to evaluate whether SPACs are worth saving. Many commentators decried SPACs' poor performance and the costs they impose on retail investors in particular, scorning SPACs as mere regulatory arbitrage that hang retail investors out to dry. This view, while having merit, overlooks SPACs' revolutionary contribution to securities markets: SPACs created a market in still-private companies, the likes of which we have not seen in the U.S. since 1933. In doing so, they offer an opportunity for us to interrogate the basic presumptions underpinning the process of going public in the U.S.—chief among them, that the retail investor is not to be trusted.

Fearful of the reckless excitement of the average investor, U.S. securities laws create a rigid framework that keeps the public out. For starters, before becoming public, almost all companies begin as private—and only wealthy institutions (notably private equity such as venture capital) and accredited investors can invest in private companies.[4] By definition, the public cannot invest in these private companies, which grow in seclusion until they are deemed ready for public involvement—a point that often falls after private investors have already seen an increase in value to their privileged investments and they, and the company's founders, are ready for a profitable exit.

We center our argument for this Article around the inherent inequity of this established process, but we begin first in Part I by detailing the background of SPAC success in the market

[1] In 2018, there were 46 SPACS as compared to 134 traditional operating company IPOs; in 2019, 59 as compared to 112; in 2020, 248 as compared to 165; and in 2021, 613 as compared to 309. JAY R. RITTER, INITIAL PUBLIC OFFERINGS: UPDATED STATISTICS (2021), Table 15a, https://site.warrington.ufl.edu/ritter/files/IPO-Statistics.pdf (excluding SPACs, closed-end funds, REITS, unit offers, IPOS with an offer price of less than $5.00, commercial banks and savings and loan companies not promptly listed on the Amex, NYSE, or Nasdaq, natural resource master limited partnerships, small best-efforts offers, and foreign companies issuing American Depository Receipts).

[2] *See infra* Part I.A.

[3] Cite.

[4] Recent crowdfunding exemptions and Reg A+ have created some opportunities at the margins.

as well as reviewing the existing literature that discusses its impacts. Part II.A of this Article moves to describe the basics of the traditional going-public process. In a conventional IPO, investment banks buy shares from a private company at a discount and sell them to the public. Section 11 of the 1933 Act imposes strict liability for any material misstatements in the IPO filings—not just on the private company doing the misstating, but also on the investment banks. Thus, in a traditional IPO, the bank is not merely a go-between, but a gatekeeper.[5] The bank will not green-light a public offering until it is satisfied that the offering will sell and not expose it to financial or legal liability.

Part III then zeroes in on the peculiar restrictions the U.S. IPO imposes on communication and sale. When going public, companies seeking to IPO are tightly constrained in what they can say and to whom they can say it. From the time a company prepares to go public, all its communication to the public funnels through the investment banks and the SEC. Fearful of "conditioning the market" and raising investor interest in still-private companies, corporations must watch their language in advertisements, be circumspect in engaging with the press, and above all refrain from providing what investors most want: projections as to their future business prospects.

Yet not all investors are treated equally in this going-public process, because the securities laws permit oral communication once a company has filed with the SEC. Certain favored (read: moneyed) investors receive projections from the company because of an exception for oral communication—these favored few are in "the room where it happens"; the general public is not. The investment banks dole out shares in the initial public offering itself, and typically only their favored clients or large institutions can buy in the "public" offering at the IPO price. Only after those IPO shares begin trading—typically after a jump in price on the first day—is the average investor granted access.

The reason for this strict process was fear of investor hysteria, and Part III.B of the Article delves into the roots behind this fear—the nature of investment banking in the 1920s and the banks' inability to control defections among themselves. The point of the '33 Act was to create a delay between when information about a still-private company first enters the public market and when those markets can trade on that information. SPACs in contrast, tell their "story" more freely, making their case in a relatively unmediated fashion to the public markets. In doing so, SPACs create a rolling market for still-private companies that—unlike with private companies or traditional IPOs—is readily accessible to the public. In the almost-poetic words of one market participant we spoke with, SPACs "allow the market to imagine what a still-private company could be."

An understanding of SPAC mechanics is critical to grasp our argument, and Part IV.A provides that background. SPACs go public via IPO as a pile of cash, promising investors that they will keep that cash safe and search for a company to acquire in the future. Investment banks underwrite the SPAC IPO, but face minimal risk because the company is a mere shell, with almost nothing to disclose. SPACs then commence a time-limited hunt for an acquisition target—a private company looking to access the public markets.[6] In this subsequent acquisition,

[5] https://www.sec.gov/rules/proposed/2022/33-11048.pdf at 88 & n.172.
[6] EVA SU, CONG. RSCH. SERV., IF11655, SPAC IPO: BACKGROUND AND POLICY ISSUES 1 (2021).

termed the "de-SPAC," the once-private firm instantly becomes public—and any shareholders not enamored of the proposed deal can redeem their shares, and get their money back before the acquisition closes. The de-SPAC is thus the functional equivalent of an IPO, effected via merger rather than public offering. And because the going-public mechanism is a merger, the IPO gun-jumping rules do not apply.

To make the difference between SPACs and traditional IPOs concrete, we need only compare the experiences of WeWork and Trump's TMTG. First, take WeWork's failed IPO. Back in 2019, WeWork's IPO was hotly anticipated.[7] The press had reported that it had filed confidential draft registration statements, and on August 14 it unveiled its first public S-1—over 220 pages long.[8] Excitement quickly turned to consternation. The filing revealed that Adam Neumann had extraordinary voting power, with each of his shares wielding 20 votes as compared to one vote for each share of common stock to be sold to the public.[9] Investors learned that if Neumann died, his wife Rebekah would be the one to appoint his successor.[10] The market also learned about a host of transactions between WeWork and Neumann, including low-interest loans to him, leases from him, and a payment of $5.9 million to Neumann for the rights to use the term "We," which he had trademarked.[11]

These revelations scandalized the markets, and the company seemed ill-prepared for investor backlash.[12] WeWork backpedaled—Neumann returned the $5.9 million (WeWork could use "We" for free after all), and agreed to a reduction to 10 votes a share instead of 20.[13] It was not enough, and WeWork shelved its IPO ambitions. Its pre-IPO valuation had been $47 billion.[14] It emerged valued at perhaps $8-9 billion, a precipitous dive.[15] But—the important point—not a single public investor lost money by investing in WeWork stock. The market assimilated all of

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[7] *See* Rebecca Aydin, *The WeWork Fiasco of 2019, Explained in 30 Seconds*, BUS. INSIDER (Oct. 22, 2019, 11:12 AM), https://www.businessinsider.com/wework-ipo-fiasco-adam-neumann-explained-events-timeline-2019-9#august-20-66 (describing WeWork's increase in advertising of IPO to increase anticipation).

[8] *The We Company Announces Confidential Submission of Draft Registration Statement for Proposed Initial Public Offering*, BLOOMBERG (Apr. 29, 2019, 2:50 PM), https://www.bloomberg.com/press-releases/2019-04-29/the-we-company-announces-confidential-submission-of-draft-registration-statement-for-proposed-initial-public-offering; David Gelles & Erin Griffith, *WeWork Takes Key Step Toward I.P.O., Citing Heady Growth and Huge Losses*, N.Y. TIMES (Aug. 14, 2019), https://www.nytimes.com/2019/08/14/business/dealbook/wework-ipo.html.

[9] Troy Wolverton, *Adam Neumann Has Locked Up Control of The We Company in a Jaw-Dropping Way, Even by Silicon Valley Standards, by Giving Himself 20 Votes Per Share*, BUS. INSIDER (Aug. 14, 2019, 4:15 PM), https://www.businessinsider.com/wework-ceo-adam-neumann-stock-gives-20-votes-a-share-2019-8.

[10] Dakin Campbell, *How WeWork Spiraled from a $47 Billion Valuation to Talk of Bankruptcy in Just 6 Weeks*, BUS. INSIDER (Sep. 28, 2019, 10:29 AM), https://www.businessinsider.com/weworks-nightmare-ipo.

[11] David Gelles et al., *WeWork C.E.O. Adam Neumann Steps Down Under Pressure*, N.Y. TIMES (Sep. 24, 2019), https://www.nytimes.com/2019/09/24/business/dealbook/wework-ceo-adam-neumann.html.

[12] *Id.*

[13] *Id. See also* Jane McGregor, *Adam Neumann's Billion-Dollar Exit Package from WeWork Is a Lesson in Giving Founders Too Much Control*, WASH. POST (Oct. 24, 2019), https://www.washingtonpost.com/business/2019/10/24/adam-neumanns-billion-dollar-exit-package-wework-is-lesson-giving-founders-too-much-control/.

[14] Alex Sherman, *WeWork's $47 Billion Valuation Was Always A Fiction Created by SoftBank*, CNBC (Oct. 22, 2019, 5:36 PM), https://www.cnbc.com/2019/10/22/wework-47-billion-valuation-softbank-fiction.html.

[15] Sarah Hansen, *WeWork Will Go Public Via SPAC Deal at $9 Billion Valuation–Less Than 20% of Its 2019 SoftBank Valuation*, FORBES (Mar. 26, 2021, 10:40 AM), https://www.forbes.com/sites/sarahhansen/2021/03/26/wework-will-go-public-via-spac-deal-at-9-billion-valuation-less-than-20-of-its-2019-softbank-valuation/?sh=65853d5634eb.

this negative information before a single share could be traded publicly.

Now take Trump's company, TMTG. To be clear TMTG is, as WeWork was in 2019, a privately held company. And yet currently there is a public market, of sorts, for its shares by way of DWAC, its SPAC partner. DWAC launched its IPO on September 9, 2021, offering its shares at $10—normal for SPACs, as Part IV will explain. On October 20, it announced plans to merge with Trump Media & Technology Group. The stock went from $9.96 to $45.50 in a day. On October 22, it closed at $94.20.[16] DWAC had created a market—an indirect market, but a market nonetheless—for the valuation of the still-private TMTG.

Bad news was on the way, however. On December 6, DWAC announced that the SEC and FINRA were investigating.[17] But it was not all bad news—DWAC announced an infusion of $1 billion should the deal close.[18] In late April, after news that TMTG was the most downloaded app on Apple's App Store, the stock gained 24% in a day.[19] Each of these disclosures caused a reaction in the price of DWAC—a reflection of the market's ongoing assessment of the prospects of the merger. Even though TMTG was still private, the SPAC had created a public market for it. This, then, is the truly revolutionary aspect of the SPAC: it creates a market in the value of still-private companies.

SPACs thus amount to a grand experiment in securities law—a rollback of the core gatekeeping mechanism of U.S. securities law, which separates the disclosure of information about a new company from its trading. We believe that this new market could benefit average investors by giving them a way to access investment in early-stage companies, access they have been denied until now. Part V provides data on how the market works. The data suggest there are at least some firms out there that prefer a SPAC to a traditional IPO, and are able to use the SPAC mechanism to both successfully raise funds and produce considerable returns for their public investors. But in order for it to work effectively, the SPAC market needs reform.

In Part VI, we first recommend imposing a requirement that 75% of SPAC shareholders believe in the deal enough to keep their money in it, an argument set up by Part V's original empirical data that reveal this simple step will go a long way to creating a viable and sustainable market for post-deSPAC companies. We argue this redemption requirement reform is a surgical approach that preserves value-increasing SPACs and is thus superior to the SEC's approach of imposing Section 11's strict liability on investment banks at the de-SPAC. If this reform measure was adopted, it would spell the end of SPACs.

With this reform in place, we make the case for SPACs to democratize access to capital and investing—although these benefits come with the cost of exposing average investors to new levels of information asymmetry and risk. Given these realties, we see the need to acknowledge that SPACs are different from the traditional operating companies they trade alongside, and

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[16] Erin Arvedlund, *Donald Trump's New Media Venture Sees Its Stock Price Soar*, PHILA. INQUIRER (Oct. 22, 2021). https://www.inquirer.com/business/technology/trump-media-venture-dwac-spac--20211022.html.

[17] Digital World Acquisition Corp., Current Report (Form 8-K).

[18] *Id.*

[19] https://www.bloomberg.com/news/articles/2022-04-27/truth-social-s-leap-to-app-store-leader-revives-trump-tied-spac.

suggest guardrails such as investor education or pre-certification. Similar requirements exist for trading in options to make sure that investors realize that they are participating a different kind of market. With these guardrails in place, we believe the SPAC market has the potential to create a valuable alternative path to the public capital markets.

I. BACKGROUND

A. Popularity and Failure

The IPO market in recent years has surged, and SPACs made up a significant and unusually high share of those IPOs: 25% percent in 2018; 34.5% in 2019, 60% in 2020, and 66% in 2021.[20] This staggering increase has meant that SPACs are now driving a considerable portion of the total IPO market. Celebrities have launched SPACs in noteworthy numbers, prompting a warning from the SEC specifically tailored to the phenomenon.[21] Sports stars including Shaquille O'Neal, Serena Williams, Alex Rodriguez, Colin Kaepernick, Steph Curry, Patrick Mahomes, Naomi Osaka, Peyton Manning, Andre Agassi, and Steffi Graff have launched their own SPACs or been associated with their founding.[22] So have celebrities Ciara, Jay-Z, and Sammy Hagar, and politicians including Paul Ryan and Wilbur Ross.[23]

Just as notably, there have been several high-profile SPAC failures. One was Nikola Motor Company, which announced its intentions in March 2020 to merge with VectoIQ Acquisition Corporation,[24] a SPAC run by a former executive of General Motors.[25] Nikola began trading on June 4, 2020.[26] By June 9, its shares had doubled.[27] By August 2020, Nikola was valued at $13 billion. But on September 21, its founder and chair Trevor Milton resigned after a short-seller firm released a report alleging fraudulent activities by the company and the SEC began

[20] In 2018, there were 46 SPACS as compared to 134 traditional operating company IPOs; in 2019, 59 as compared to 112; in 2020, 248 as compared to 165; and in 2021, 613 as compared to 309. JAY R. RITTER, INITIAL PUBLIC OFFERINGS: UPDATED STATISTICS (2021), Table 15a, https://site.warrington.ufl.edu/ritter/files/IPO-Statistics.pdf. Excluding SPACs, closed-end funds, REITS, unit offers, IPOS with an offer price of less than $5.00, commercial banks and savings and loan companies not promptly listed on the Amex, NYSE, or Nasdaq, natural resource master limited partnerships, small best-efforts offers, and foreign companies issuing American Depository Receipts).

[21] Celebrity Involvement with SPACs – Investor Alert, U.S. SEC. & EXCH. COMM'N (March 10, 2021) (warning in bold that "*[i]t is never a good idea to invest in a SPAC just because someone famous sponsors or invests in it or says it is a good investment*.")

[22] Amrith Ramkumar, *The Celebrities from Serena Williams to A-Rod Fueling the SPAC Boom*, WALL ST. J. (March 17, 2021), https://www.wsj.com/articles/the-celebrities-from-serena-williams-to-a-rod-fueling-the-spac-boom-11615973578.

[23] *Id*.

[24] Kristi Marvin, *VectoIQ Acquisition Corp. (VTIQ) to Combine with Nikola Corporation*, SPACINSIDER (Mar. 3, 2020), https://spacinsider.com/2020/03/03/vectoiq-to-combine-with-nikola-corporation/.

[25] *See generally* VECTOIQ, https://www.vectoiq.com (last visited July 29, 2021).

[26] John Rosevear, *Done Deal: VectoIQ's Merger with Nikola Motor Has Closed*, MOTLEY FOOL (June 3, 2020, 2:14 PM), https://www.fool.com/amp/investing/2020/06/03/done-deal-vectoiqs-merger-with-nikola-motor-has-cl.aspx.

[27] Ben Foldy, *Electric-Truck Startup Nikola Bolts Past Ford in Market Value*, WALL ST. J. (June 9, 2020, 10:50 PM), https://www.wsj.com/articles/electric-truck-startup-nikola-bolts-past-ford-in-market-value-11591730357.

investigations.[28] The resignation caused a 35% drop in share prices.[29] Milton was indicted in July of 2021 and faces criminal and civil securities fraud charges.[30]

Lordstown Motors, another electric-vehicle startup, made headlines when President Trump highlighted its efforts to reopen a shuttered General Motors factory in Ohio. Lordstown merged with a SPAC in October of 2020, touting "tens of thousands of 'pre-orders' for its pickup truck."[31] Once public, news came that these "pre-orders" were nonbinding. Its CEO and CFO have resigned, and the SEC is investigating as of the time of this writing.[32]

This surge in SPAC activity has brought corresponding interest from regulators. In early 2021, the Division of Corporation Finance issued public statements aimed directly at SPACs.[33] A subcommittee of the U.S. House of Representatives Committee on Financial Services held a hearing on Going Public: SPACs, Direct Listings, Public Offerings, and the Need for Investor Protections.[34]

Then, on March 30, 2022, the SEC proposed new rules to regulate SPACs.[35] These proposed reforms seek to regulate many aspects of SPACs, and one of their overall goals is to "align de-SPAC transactions with initial public offerings." Two reforms are most relevant for our purposes. First, the SEC proposed to eliminate the PSLRA safe harbor that allowed SPACs to make forward-looking statements in the de-SPAC (whereas IPOs traditionally do not).[36] Second, the SEC proposed rules deeming participants in the de-SPAC to be underwriters, and thus subjecting banks, as well as the target and possibly other de-SPAC participants, to Section 11's strict liability.[37]

This leveling of the playing field has conceptual appeal; indeed, both of us endorsed this

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[28] *Nikola: How to Parlay an Ocean of Lies into a Partnership with the Largest Auto OEM in America*, HINDENBURG RSCH. (Sept. 10, 2020), https://hindenburgresearch.com/nikola/; Claudia Assis, *Nikola Corp. Details New SEC Probe*, MKT. WATCH (May 7, 2021, 11:48 AM), https://www.marketwatch.com/story/nikola-corp-details-new-sec-probe-2021-05-07.

[29] Christine Wang & Marty Steinberg, *Nikola Founder Trevor Milton to Voluntarily Step Down as Executive Chairman; Stock Plunges*, CNBC (Sept. 21, 2020, 1:54 AM), https://www.cnbc.com/2020/09/21/nikola-founder-trevor-milton-to-voluntarily-step-down-as-executive-chairman.html.

[30] Matthew Goldstein & Niraj Chokshi, *Nikola Founder Is Charged with Fraud in Rebuke to Wall Street*, N.Y. TIMES (July 29, 2021), https://www.nytimes.com/2021/07/29/business/nikola-trevor-milton-fraud.html?searchResultPosition=1.

[31] Matthew Goldstein, Lauren Hirsch & Neal E. Boudette, *Lordstown, Truckmaker that Can't Afford to Make Trucks, Is on the Brink*, N.Y. TIMES (June 14, 2021), https://www.nytimes.com/2021/06/14/business/lordstown-motors-steve-burns-julio-rodriguez.html.

[32] *Id.*

[33] John Coates, *SPACs, IPO's and Liability Risk under the Securities Laws*, U.S. SEC. & EXCH. COMM'N (April 8, 2021), https://www.sec.gov/news/public-statement/spacs-ipos-liability-risk-under-securities-laws.; John Coates & Paul Munter, *Staff Statement on Accounting and Reporting Considerations for Warrants Issued by Special Purpose Acquisition Companies ("SPACS")*, U.S. SEC. & EXCH. COMM'N (Apr. 12, 2021), https://www.sec.gov/news/public-statement/accounting-reporting-warrants-issued-spacs.

[34] *Going Public: SPACs, Direct Listings, Public Offerings, and the Need for Investor Protections Before the Subcomm. on Investor Protection, Entrepreneurship and Capital Markets of the H. Comm. on Fin. Services*, 117 Cong. (2021), https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=407753.

[35] https://www.sec.gov/rules/proposed/2022/33-11048.pdf.

[36] Id. at 82.

[37] Id. at 96-98.

approach early on, before the gathering and analysis of the data presented here.[38] But our data suggest that SPACs may create something of value—a market that circumvents an investment-bank-heavy process and thereby creates an alternate mechanism for both valuing a still-private company and introducing that company to the public capital markets. In short, SPACs are in the spotlight—the focus of attention of retail investors, the press, and regulators. Scholars have also turned their attention to SPACs, and the next Section describes this literature and situates our contribution to it.

B. Literature

The literature on IPOs is vast. We do not try to summarize it here. We have previously published two papers on SPACs, now almost a decade ago.[39] With the most recent SPAC surge, there has been a corresponding increase in interest in the form. We offer here a brief review of recent literature, most of which has focused on problems with the acquisition process.

Recent empirical contributions to the literature include *Segmented Going-Public Markets and the Demand for SPACs* by Jessica Bai et al., which examines empirical data on SPAC issuance and comparison to traditional IPO firms.[40] Passador studies SPACs as an investment phenomenon, with a focus on understanding institutional investors' participation and the impact of COVID.[41] Saengchote explores "mispriced SPACs" (SPACs that trade above $10) in electric vehicle SPACs.[42] Gahng, Ritter, and Zhang consider investment returns from the January 2010–May 2018 evolution of SPACs, specifically narrowing in on warrant-pricing practices and the increasing sponsor contributions that make SPACs less attractive investments at IPO but lessen the dilutive effects at the de-SPAC while still contributing to better investments for post-merger shareholders.[43]

One of the most notable empirical contributions in the legal literature for our purposes here has been that of Klausner et al., who argue for more standardized disclosure—and for more disclosure more broadly—at the time of acquisition, as well as for uniform rules regarding forecasting and liability between SPACs and traditional IPOs.[44] They contend that the SPACs represent a sweet deal for the IPO investors—which are largely hedge funds—that buy in the IPO, but a poor deal for the retail investors who buy from those initial investors.[45] Klausner et al. focus their attention on the SPACs that completed acquisitions January 2019–June 2020,

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[38] Cite Usha's congressional testimony.

[39] Usha Rodrigues & Mike Stegemoller, *What All-Cash Companies Tell Us about IPOs and Acquisitions*, J. CORP. FIN. 111 (2014); Usha Rodrigues & Michael Stegemoller, *Exit, Voice, and Reputation: The Evolution of SPACs*, 37 DEL. J. CORP. L. 849 (2013);.

[40] Jessica Bai, Angela Ma & Miles Zheng, *Segmented Going-Public Markets and the Demand for SPACs* (2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3746490.

[41] Maria Lucia Passador, *In Vogue Again: The Re-rise of SPACs in the IPO Market* (U. of Luxembourg L., Working Paper No. 2021-005, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3820957.

[42] Kanis Saengchote, *The Tesla Effect and the Mispricing of Special Purpose Acquisition Companies* (2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3800323.

[43] Minmo Gahng, Jay R. Ritter & Donghang Zhang, *SPACs* (2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3775847.

[44] Michael Klausner et al., *A Sober Look at SPACs*, EUR. CORP. GOVERNANCE INST. 3 (Jan. 2022), http://ssrn.com/abstract_id=3720919, at 58–59.

[45] *Id*. at 4.

which comprise a sample of 47 firms in the most recent iteration of SPAC evolution.[46]

Several recent articles focus specifically on the question of regulatory arbitrage. Philippe Maupas and Luc Paugam make their case directly in their title, *Regulatory Arbitrage on Narrative Steroids: The Case of SPACs*, arguing that SPACs perform poorly long-term but that regulatory arbitrage enables them to create positive narratives to promote the form.[47] Amanda M. Rose, in contrast, questions claims of regulatory arbitrage, pointing out the difference between SPAC markets and traditional IPO markets.[48] In highlighting the "inefficient" yet "retail-accessible" market for SPACs, she describes the risks to investors of the pre-filing publicity available to SPACs, which might "cause investors to form a sticky premature opinion" as to the value of the target.[49] She comes closest to the concerns we address here.

Harald Halbhuber details the differences in the regulation standards that apply to SPACs, despite their being the functional equivalent of IPOs, and advocates regulation based on economic substance.[50] In his excellent piece, he discusses some aspects of the market that SPACs create, including companies evading gun-jumping rules and selling before the SEC has reviewed disclosure.[51] But he focuses on the ramifications of the SPAC being a functional equivalent on the IPO, rather than squarely on the new market in information the SPAC creates.

II. TRADITIONAL IPOS

This Part establishes the necessary context of traditional IPOs, because the SPAC form only makes sense when situated against that backdrop. Section A describes the modern IPO process, and Section B focuses on the concern that the public will be whipped up into a frenzy and overbid for new offerings untested in the public markets.[52] This concern is well-placed: the 1933 Act, as we will see in Part III, was inspired by the heightened fraud risk that arises when unscrupulous individuals are allowed to promise blue skies and untold riches from investments in untested companies. Even now, despite the best efforts of the regulators, a good deal of excitement and uncertainty often marks the debut of a company onto the public stage.

These pressures culminate in underpricing, the phenomenon where, on the first day of trading, the stock trades above—sometimes far above—the issue price set by the investment-bank underwriter (the first day "pop").[53] While the pop comes near the end of the timeline,[54] it is

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[46] *Id*. at 3.

[47] Philippe Maupas & Luc Paugam, *Regulatory Arbitrage on Narrative Steroids: The Case of SPACs* (2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3985936.

[48] Amanda M. Rose, *SPAC Mergers, IPOs, and the PSLRA's Safe Harbor: Unpacking Claims of Regulatory Arbitrage* (2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3945975

[49] *Id*. at 11.

[50] Harold Halbhuber, *An Economic Substance Approach to SPAC Regulation* (2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4005605.

[51] *Id*. at 21–24.

[52] *See* Randall v. Loftsgaarden, 478 U.S. 647, 659 (1986) (the Act also "aim[s] ... to prevent further exploitation of the public by the sale of unsound, fraudulent, and worthless securities through misrepresentation [and] to place adequate and true information before the investor.") (quoting S.Rep. No. 47-73, at 1 (1933))

[53] Alexander Ljungqvist, *IPO Underpricing*, *in* HANDBOOK OF CORPORATE FINANCE: EMPIRICAL CORPORATE FINANCE VOLUME 1 (B. Espen Eckbo ed., 2007).

[54] *See generally id.*; *see also* Julia Kagan, *Public Offering Price (POP)*, INVESTOPEDIA (Aug. 26, 2020),

an indicator of the excitement that attends every step in the offering. Section C focuses special attention on the phenomenon of underpricing and the question of whether investor hysteria is its cause or merely a correlate.

Thus, U.S. securities laws treat the going-public process as a fraught time and train most of their focus on would-be investors' lack of knowledge about the firm. The 1933 Act's structural solution was to introduce the mandatory waiting period that now exists between public filing and trading. This was a real innovation, as Section D will explain. Even if the waiting period did not exactly solve the information asymmetry problem, it ameliorated two of its symptoms in important ways.

A. The Conventional IPO Process

The investment bank serves as the gatekeeper for the traditional public offering, shepherding the company through the IPO process.[55] In a firm commitment offering, the bank buys the shares from the company and then sells them to the public.[56] The underwriter's compensation typically consists of a 7% discount (or "spread") that it receives from the company: it buys the shares at that discount, then sells them to the public at full price.[57] The bank thus takes on some economic risk—"some" because the bank has ways to mitigate the risk of not being able to resell all the shares it has purchased from the company.

The process of gauging interest in the IPO, called "book-building," is generally conducted in such a manner as to ensure that the IPO is oversubscribed.[58] The lead or managing underwriter runs the offering and deals most closely with the issuer, but it also coordinates a group of banks—the syndicate—that help with the marketing and sale of the offering.[59] As a result of this dynamic, the bank undertakes an intermediary function, and will not go forward with an IPO unless it is sure that it will be able to sell the shares to the investing public.[60]

In modern-day IPOs, communication in the time before a private firm's debut is highly regulated.[61] Part III.A will delve deeply into this period, which is characterized by profound misgivings about the public's ability to process information about a new firm in a rational manner. This mistrust is a key focus of this Article, but the focus of this Part is an overview of the going-public process.

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https://www.investopedia.com/terms/p/publicofferingprice.asp.

[55] Noam Sher, *Underwriters' Civil Liability for IPOs: An Economic Analysis*, U. PA. J. INT'L ECON. L. 389, 392, 395 (2006).

[56] *Id.*

[57] *See* DAVID A. WESTENBERG, INITIAL PUBLIC OFFERINGS: A PRACTICAL GUIDE TO GOING PUBLIC § 19:2 (2012). The spread for large issuers can be much lower.

[58] *Id.*

[59] Samuel N. Allen, *A Lawyer's Guide to the Operation of Underwriting Syndicates*, 26 NEW ENG. L. REV. 319 (1991). Often syndicate members will have different strengths that complement those of the lead underwriter. *Id.* (describing the reasons why an underwriter would invite other firms to the syndicate).

[60] *See* Patrick M. Corrigan, *The Seller's Curse and the Underwriter's Pricing Pivot: A Behavioral Theory of IPO Pricing*, 13 VA. L. & BUS. REV. 335 (2019).

[61] *See* Susan B. Heyman, *The Quiet Period in a Noisy World: Rethinking Securities Regulation and Corporate Free Speech*, 74 OHIO ST. L.J. 189, 196–204 (2013).

U.S. securities laws divide the offering process into distinct time periods with distinct rules regarding communication in each.[62] Before the filing of the first public registration statement via Form S-1, the company is in the "quiet period."[63] So-called "gun-jumping" rules prohibit the issuer or underwriter from saying much either about the firm's prospects in general or about the offering in particular.[64]

The exact beginning of the quiet period can be difficult to identify, but once a company is in it, it must be careful not to "jump the gun." Part III treats them in more detail, and provides the historical context for them because understanding how they operate—and, as importantly, *why* they operate in this fashion—will set the stage for understanding SPACs' true innovation in securities law. For purposes of providing a general overview of the IPO process, however, for now we will just acknowledge that complex gun-jumping rules apply to any communications from and about the issuer.

After the issuer files its first S-1, typically confidentially, the SEC reviews it and makes comments. Indeed, the SEC reviews multiple drafts of the S-1, scrutinizing the statements for clarity and requesting more information.[65] At the same time, given its liability for misstatements in the registration statement, the investment bank is also combing the S-1 for material misstatements and omissions in a process known as due diligence.[66] While there is no explicit prohibition on forward-looking statements being made in the S-1 or during the road show, investment banks generally forbid it.[67] This de facto prohibition has to do with the liability that the investment bank faces in the IPO.

Anti-gun-jumping rules continue to apply once the S-1 is publicly filed and the next phase of the offering process begins—the waiting period. The company is not passively waiting for the IPO, however, but rather embarks on a "road show" where it tells its story to institutional investors and to certain members of the retail public.[68] These investors benefit from an exception to gun-jumping rules for oral communications—as long as there is no written or video recording, the company and its bankers can and do speak freely.

Many rules and regulations continue to govern during the waiting period. Offers are now permissible, but not sales, so the bank builds its "book" of interest in the offering—"soft" expressions of interest in the offering that fall within a certain price range.[69] Finally, once the SEC has given the green light to the offering, the investment bank assesses the information it has gathered during the due-diligence process and the road show.[70] It makes its case to an internal commitment committee.[71] The bankers working the offering must convince this committee that

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[62] *See id.* at 196.

[63] *See* WESTENBERG, *supra* note 58, § 11:5.

[64] Heyman, *supra* note 62, at 197.

[65] *See Filing Review Process*, U.S. SEC. & EXCH. COMM'N (last modified Sept. 27, 2019), https://www.sec.gov/divisions/corpfin/cffilingreview.htm; *id.* at 5, A-8 (listing out the requirements of Form S-1).

[66] *See* Usha Rodrigues, *The Effect of the JOBS Act on Underwriting Spreads*, 102 KY. L.J. 925, 933–34 (2013).

[67] *See* WESTENBERG, *supra* note 58, at § 13:2.1[D].

[68] *See id.* § 18:4.

[69] *Id.* § 18:4–18:9.

[70] *Id.* at § 10:3.6.

[71] *See* Joseph K. Leahy, *What Due Diligence Dilemma? Re-Envisioning Underwriters' Continuous Due*

the offering is worth putting the bank's money and reputation on the line.[72] With the committee's assent, it prices the offering and sells it to the IPO investors who expressed interest during the book-building process.[73] Failure of any of these steps means that the investment bank will halt the IPO.[74]

A pause is in order here to highlight the gatekeeping role that the lead underwriter plays in the IPO process. One vaunted advantage that SPACs offer is their ability to circumvent this gatekeeper and raise money on the capital markets even if they are disfavored by banks because of their large capital needs and limited prospects for short-term revenue.[75] Electric-vehicle,[76] lithium-battery,[77] and clean-energy[78] companies, for example, have gravitated to SPACs in recent years for this reason.

Typically, investment banks allocate IPO shares only on the brink of the IPO and reserve these IPO allocations for their favored customers—institutional clients and wealthy individuals with large accounts.[79] For now it is enough to note that, although the IPO marks the debut of a company's shares on the open market, only a select group of investors can purchase IPO shares—an important fact, given the probability of significant one-day appreciation after the stock begins to trade.

If the offering *does* price, this is when excitement can peak. Some subset of these IPO investors sell their shares on the secondary market, and demand can be intense for this sliver of shares—the first market truly open to the general public. Despite all the SEC's actions to try to tamp down investor excitement, the share prices typically "pop" in the first day of trading. For example, Airbnb's IPO priced at $68 a share, and soared in first-day trading to close at $144, an increase of 113%.[80] DoorDash's IPO similarly surged 86% on opening day.[81]

These first-day pops are the rule, not the exception—systematic underpricing is a documented feature of U.S. IPOs.[82] Indeed, Adam Pritchard observes that, rather than capital-raising events, IPOs are more like debutante balls: "Like wearing a fabulous gown to a ball, newly public companies jostle for a bump in first day trading in order to be noticed and attract trading volume."

Diligence After Worldcom, 30 CARDOZO L. REV. 2001, 2056–57 (2009).

[72] *See id.*

[73] LATHAM & WATKINS LLP, US IPO GUIDE: 2021 EDITION 8 (June 15, 2021), https://www.lw.com/thoughtLeadership/lw-us-ipo-guide.

[74] *See* WESTENBERG, *supra* note 58, at § 10.

[75] See https://hbr.org/2021/07/spacs-what-you-need-to-know.

[76] See Fisker, Lucid Group, Faraday Future Intelligent Electric, Canoo, Nikola, Lordstown Motors.

[77] See Li-Cycle, Enovix

[78] Sunlight Financial, Altus Power,

[79] Cite.

[80] *See* Andrew Ross Sorkin et al., *Airbnb's Stunning I.P.O.*, N.Y. TIMES (Dec. 11, 2020), https://www.nytimes.com/2020/12/11/business/dealbook/airbnb-ipo-chesky.html (reporting how Airbnb's shares were set to begin trading at $139 after its IPO had priced them at $68).

[81] *Id.*

[82] Ljungqvist, *supra* note 48. The underpricing of IPOs is not a phenomenon peculiar to the U.S. capital markets, either. *See* Pritchard, *supra* note 17, at 1014.

The media treat a sharp rise in the aftermarket price as a reflection of the offer's success, often ignoring the money left on the table during the book-building process.[83] But this "pop" can also be viewed as an indictment of the traditional IPO mechanism. Highly compensated investment bankers work with companies for months, assessing their prospects and gauging investor interest over the course of a multi-week roadshow. And yet these highly sophisticated market participants reliably underprice the issues they sell. The twin puzzles are why this systematic error occurs, and whether it is a problem—whether underpricing indicates a bias in the system.

B. Investor Hysteria

Armed with that overview of the modern IPO process, we can focus in on why it is structured the way it is. The animating concern of securities laws is that the general public is prone to hysteria when it comes to new stock issuances. U.S. securities laws rely on the gatekeeping of the underwriting banks to intermediate that process—and in the process, ensure that the initial buyers of public shares are not average investors at all.

There are two main reasons for investor hysteria. The first is that the defining characteristic of this IPO-unveiling period is uncertainty riddled with—and spurred by—asymmetric information. Most obviously, investors face a tremendous informational disadvantage. The firm's insiders know future revenues, costs, prospects, risks, product markets, far better than do outside observers.[84] Outsiders should naturally distrust insiders, given their incentive to exaggerate the firm's strong points and minimize its weaknesses.[85]

In the absence of the public markets' scrutiny, private firms are freer to make grand claims than their public counterparts. Anti-fraud rules apply, of course, but private firms can brag about their prospects with fewer repercussions because their only buyers are wealthy investors and institutions; the threat of a class action is low. A private firm's ability to speak freely becomes particularly dangerous when that firm is on the cusp of going public. Statements linger, whether in the press or on the internet, and boasts made when the company is on the verge of an IPO might still resonate in the market weeks or months later, after the public offering, when the general public can purchase shares. Thus, gun-jumping rules reach back in time, to before the IPO formally begins.

Further fueling investor interest is the fact that private firms have the luxury of being a black box upon which an eager public can project its dreams of "striking it rich." In contrast, public companies must regularly disclose the ins and outs of their business in periodic filings,

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[83] Pritchard, *supra* note 17, at 1014–15. Facebook's lack of IPO pop (compounded by technological glitches) caused many in the financial press to call it a disappointment, even a failure. *See, e.g.*, Tim Worstall, *The Failure of Facebook's IPO*, FORBES (May 20, 2012). Others pointed out that Facebook, by avoiding a pop, maximized the capital raised for the company—it avoided "leaving money on the table." *See, e.g.*, Nathan Vardi, *The Big Winner in the Facebook IPO: Zuck!*, FORBES (May 18, 2012, 1:44 PM). Looked at in this light, the company's IPO was highly successful.

[84] *See* Boyd D. Cohen & Thomas J. Dean, *Information Asymmetry and Investor Valuation of IPOs: Top Management Team Legitimacy as a Capital Market Signal*, 26, STRATEGIC MGMT. J. 683, 683–84 (2005).

[85] *See id.*

thus yielding less intrigue and thereby less potential for outsized returns for a potential investor. In addition to the fascination fueled by the opaqueness of private companies' inner workings, potential investors have one certainty feeding their excitement: investors in the IPO are likely to make money, because of the systematic underpricing that characterizes the IPO market.

This brings us to the second reason for investor hysteria: the first-day pop. IPO shares predictably rocket in value on the first day of trading, and that fact makes them undeniably valuable. Theories abound as to the cause of this systematic underpricing, and these theories are entirely relevant to our central question as to whether SPACs present a viable alternative mechanism over the traditional IPO pricing mechanism for some firms; after all, SPACs, in dispensing with the quiet period and creating a market in private companies, can only be justified if we do not believe that investor hysteria inevitably accompanies a new public offering—or at least, that it is not problematic enough to justify regulation of that market. In other words, SPACs allow an alternate way of neutralizing the investor hysteria that has traditionally justified the strictures of the '33 Act.

C. Underpricing

Underpricing imposes real costs to the issuer.[86] The difference between the offering price and the price at which the shares close on the first day represents capital raising foregone, a cost that can far eclipse the nominal costs of fees and the underwriting spread—presuming, at least, that all or most of the offered shares would sell at the closing price.[87] Under this view, every investor who profits from the IPO "pop" does so at the expense of the company.

Underpricing's second cost is to retail participants. While some offerings flirt with a more democratic approach, most IPO buyers are institutional investors.[88] Some retail investors can also participate, but the typical practice is that underwriters dole out IPO allocations to their own customers. The general public does not have access to these shares.[89]

Some theories of underpricing focus on investor excitement to explain the first-day pop. Enthusiasm from the public—sometimes approaching speculative frenzy—attends these debuts on the public markets. Adam Pritchard calls this a "lottery ticket mentality," where retail investors may be looking for the next Apple or Microsoft, and are willing to tolerate subpar returns on the chance of hitting it big.[90] Pritchard raises the possibility that speculative frenzy among retail investors is what drives the pop, a kind of "momentum trading on steroids" where

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[86] *See* Sean J. Griffith, *Spinning and Underpricing: Legal and Economic Analysis of the Preferential Allocation of Shares in Initial Public Offerings*, 69 BROOK. L. REV. 583, 599–630 (2004).

[87] *See id.*

[88] Beatrice Boehmer et al., Do Institutions Receive Favorable Allocations in IPOs with Better Long-Run Returns? 41 J. Fin. & Quantitative Analysis 809, 814 ("For a diverse sample of international IPOs, Ljungqvist and Wilhelm (2002) find that average allocations to institutional investors are two to three times higher than to retail investors. This is comparable to our sample, where institutions receive 3.3 times as many shares as retail investors.").

[89] Thomas S. Conner, Underpricing in the Initial Public Offering: A Solution for Severely Affected Issuers, 4 Sec. Reg. L.J. 3 (2012); John M. Griffin et al., Why Are IPO Investors Net Buyers Through Lead Underwriters, 85 J. Fin. Econ. 518 (2007).

[90] Pritchard, *supra* note 17, at 1016.

"the runup is driven at least in part by the run up itself."

Irrational retail-investor exuberance also explains another underpricing theory, which holds that sophisticated institutional investors, crucial to the IPO because of their ability to buy large quantities of shares,[91] will avoid IPOs entirely if retail investors can freely participate. Retail investors are basically placing bets, and without the underwriting process to filter out their participation, more sophisticated bidders, who invest time and money in accurate pricing, are squeezed out by investors "who do not adequately understand the optimal bidding strategies and perhaps have no information on the value of the shares."[92] Thus, in the words of Pritchard: "underpricing is simply the byproduct of the need to exclude the undesirables from the initial pricing process. Once the dumb money piles into the secondary market, all bets are off.[93] This theory also explains why auction-pricing mechanisms have not taken root in the IPO process—auctions essentially avoid the highly managed book-building process of investment banks because they have no mechanism to filter out retail investors.

Other theories of underpricing are not so investor-hysteria driven. One looks simply to the laws of supply and demand and also, indirectly, places the blame for underpricing on the overly excitable retail investor. To begin with, not *all* of the firm's stock is sold in the IPO—indeed, typically only around 25% of the firm's total shares. First, especially at IPO, a considerable percentage of shares will be held by employees, founders, and institutional investors who cannot generally sell from the IPO up to 180 days afterwards, because of lock-up agreements. And second, out of the many investors who bought in the IPO, at least some percentage are not interested in profiting from a one-day run up—perhaps they believed the road show, which was after all about building up long-term investors who will stick with the company.[94] Out of all of the issuer's shares, only a small percentage—1 to 3%, by Scott Kupor's calculation—in an IPO will actually trade on that first day.[95] And given the intense retail interest that we have already seen accompanying a new issuance, a significant increase in price is inevitable, especially as this is the general public's first crack at the apple. Because it is only a very small slice of the apple, in the short term, the price will pop.

There are other theories that explain underpricing as a deliberate move by the lead underwriter to *court* the retail investor—in these theories, the retail investor, far from being irrationally eager, is rationally suspicious. Kevin Rock posits that banks underprice IPOs in order to attract the uninformed investors.[96] Without the promise of a reliable underpricing discount, these retail investors, with their lack of market power, would receive all of the *over*priced issuances, and none of the underpriced ones (being uninformed as to their value). They would thus tend to avoid IPOs altogether. Because the institutional investor market cannot handle all initial offerings, the uninformed investor—that is, the retail investor—is a necessary part of any offering, and must be able to rely on systematic compensation in order to be coaxed

[91] *Id.*

[92] Ravi Jagannathan, Andrei Jirnyi & Ann Sherman, *Why Don't Issuers Choose IPO Auctions? The Complexity of Indirect Mechanisms* 1, 28 (Nat'l Bureau of Econ. Rsch., Working Paper No. 16214), http://www.nber.org/papers/w16214.

[93] Pritchard, supra note 17, at 1014.

[94] *Id.*

[95] Cite

[96] Rock, *supra* note 54, at 188.

to participate.

Beneviste and Spindt go one better, and posit that IPO underpricing is a type of compensation for something that initial buyers provide—it rewards investors for giving up their information about the valuation of the issuer. They argue: "Investors have no incentive to reveal positive information before the stock is sold. By keeping such information to themselves until after the offering, investors can expect to benefit; they would pay a low initial price for the stock and then could sell it at the full information price in the post offering market."[97] IPO prices thus are set low enough to compensate investors for giving up information about the issuer.

Loughran and Ritter take a decidedly more cynical view. They point out that pre-IPO managers, most of whom do not sell in the IPO but rather after it (because of lockups), will benefit from the runup in stock.[98] Moreover, underwriters benefit from underpricing because, although nominally forgoing some compensation in terms of lower revenues from the spread, they benefit from reduced marketing costs (IPOs, if predictably underpriced, can more or less sell themselves) and they receive benefits such as higher commissions from their investors looking to get in on hot allocations.[99] Under this view, even as private companies become attainable to the general public, the wealthy take their cut. This more cynical view emphasizes an undeniable fact, no matter to which theory you subscribe: underpricing makes IPO shares valuable because of the near-certain first-day gain accompanying them.

Underpricing imposes costs on issuers who forgo the first-day gains, and on the retail investors who are left out of those first-day gains. Most of the theories justifying underpricing rely, in one manner or the other, on the assumption that the retail investor is a problematic participant in these initial public markets—hearkening back, again, to the concept of investor hysteria and the fear that retail investors will be swept up in the excitement of an initial offering. Under this view, underwriters are necessary gatekeepers that protect the general public from themselves—and perhaps extract rents as the price of doing so.[100] SPACs show the potential for another path: one that can, with adjustment, allow the market itself to perform the role of gatekeeper, and offer issuers and retail investors disfavored by investment banks a chance to participate in the public capital markets.

A lot turns out to hinge on whether we think we should trust retail investors to invest debuting firms—to hinge, in other words, on the extent to which retail-investor hysteria is a problem. To understand the extent to which securities law focuses on this question of protecting retail investors as a company goes public, we need to explore the origin of today's gun-jumping

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[97] Lawrence M. Benveniste & Paul Spindt, *How Investment Bankers Determine the Offer Price and Allocation of New Issues*, 24 J. FIN. ECON. 343, 344 (1989).

[98] Tim Loughran & Jay R. Ritter, *Why Don't Issuers Get Upset about Leaving Money on the Table in IPOs?,* 15 REV. FIN. STUD. 413, 414 (2015). They explore reasons such as spinning, where underwriters allocate hot IPOs to venture capitalists and company executives to curry favor and future business with them—a practice commonplace in the late '90s—and firms' willingness to select underwriters with highly ranked analyst coverage, even if those banks tend to underprice offerings. *Id.* at 416, 437.

[99] Christine Hurt, *Moral Hazard and the Initial Public Offering*, 26 CARDOZO L. REV. 711, 724 (2005) (explaining the incentives underwriters have to underprice an IPO).

[100] Secondmarket/Sharespost are markets of a kind, and the UK is providing a new market for private firms innovation.

rules.

III. GUN-JUMPING, PRESENT AND PAST

A. Gun-Jumping Rules

The details of gun-jumping rules have bedeviled generations of securities law students. They are highly technical and can seem abstruse and, given the prevalence of secondary offerings and exceptions for them, downright old-fashioned. But the main point of this Article is that these esoteric rules served and continue to serve a key function in modern IPOs—a function that SPACs have completely circumvented. Simply put, SPACs allow sales of pre-public companies based on hype—which is precisely what gun-jumping rules seek to prevent. So in this Part, we focus our attention on what these rules look like and why we have them.

We start with the basics, and we begin at the end of the IPO timeline. The underwriting banks buy the shares from the issuer at a discount and sell them to the public. But in the lead-up to the IPO, neither a company nor agents working on its behalf—the underwriting syndicate—may make binding agreements to sell shares of the company until the IPO.[101] This is, when one thinks about it, a fairly extraordinary way of going about creating a market for a soon-to-be-public firm. The underwriting bank, in a firm commitment offering, buys the shares from the issuer and then resells them—but cannot make binding sales itself until the actual IPO.[102] The most it can do is collect expressions of interest, where investors indicate that they'd like a certain number of shares if, hypothetically speaking, they were to be priced in a certain price range.[103] Remember one risk-mitigation strategy the banks have adopted in the face of this stricture is to build a "book" of interest several times above and beyond that which it thinks it will need to complete the offering. These oversubscriptions of soft commitments in turn may help to explain the first-day pop.

This enforced hypotheticality explains another risk-mitigation method the banks have developed—banks only sign a definitive underwriting agreement with the issuer (that is, only make a binding commitment to buy the shares) and price the shares after the SEC has green-lighted the offering. That is, the banks don't agree to buy until they know they have enough interest to sell at a given price, and the SEC's blessing. Basically, up until the actual day of the IPO, no one commits to anything. This uncertainty as to not just the price of an IPO, but also as to whether it will occur *at all*, makes SPACs relatively more attractive as a path toward going public. It is also, as Part IV.A explains, deeply problematic because it eliminates all gatekeepers from the going-public process.

But the 1933 Act does more than forbid binding commitments to buy; issuers may not even make explicit *offers* to sell except at certain times and under certain circumstances.[104]

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[101] 15 U.S.C. § 77e(c); *see also Registration Requirements Under the Securities Act of 1933*, 18 IND. PRAC. BUS. ORGS. § 14.8 (West 2021) (describing § 5 and the various activities prohibited at each stage of the process).

[102] 15 U.S.C. § 77e(c).

[103] *See* Allen, *supra* note 60.

[104] 15 U.S.C. § 77e.

Rewinding back in the IPO timeline, the first time the public actually gets a look at the company's information is when the S-1 is publicly filed. Recall that the company has been in dialogue with the SEC quite a bit by this point, and to get to the publicly filed S-1, it has likely received several rounds of comments on confidential draft registration statements. After the S-1 is filed, oral (but not written) offers must be made via the prospectus filed with the SEC; before then, neither the issuer nor anyone acting on its behalf may offer securities for sale.[105] And once the S-1 is filed, offers must be made solely via or in conjunction with the prospectus.[106] While this requirement has relaxed somewhat with the introduction of free-writing prospectuses, it remains the case that, even after the first S-1 is made public on the SEC website, any offer must refer potential investors back to the prospectus for full details.[107] These rules have the effect of requiring all communications to funnel back to the SEC-filed prospectus.

Finally, we can rewind back to the quiet period, the time period before the public first sees the S-1. During the quiet period, not only can the issuer not sell its securities outright, but the issuer and the banks cannot even make any oral *offers* to sell. Even more constraining, beyond explicit offers to sell, the issuer must not say anything to advertise the offering or "condition the market."[108]

"Conditioning the market" refers to the risk that issuers will put out favorable information that will then color how potential purchasers view the eventual official disclosure.[109] In the SEC's view, all communications that may condition the market for the securities being offered can constitute an offer under Section 2(a)(3).[110] The first-day pop is either a cause or a symptom of the anticipation that proceeds some IPOs, and the SEC has voiced particular concern in these instances: "Indeed, the danger to investors from publicity amounting to a selling effort may be greater in cases where an issue has "news value" since it may be easier to whip up a 'speculative frenzy' concerning the offering by incomplete or misleading publicity and thus facilitate the distribution of an unsound security at inflated prices. This is precisely the evil which the Securities Act seeks to prevent."[111]

The firm is highly circumscribed in terms of what it can say about the business and its prospects, and the government will scrutinize the manner of communication, the content of the message, and the method of distribution.[112] For initial public offerings, issuers cannot say *anything* about the impending offering, and very little that is not routine practice about the company in general.[113] Importantly, any communication that touts a firm's prospects is particularly frowned upon and is presumed to be conditioning the market.[114]

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[105] *Id.* § 77e(b).

[106] *Id.* § 77e(b)(2).

[107] *Id.*

[108] Heyman, *supra* note 62, at 230–31.

[109] Robert B. Thompson, *Securities Regulation in an Electronic Age: The Impact of Cognitive Psychology*, 75 WASH. U. L.Q. 779, 783–84 (1997) ("The policy of the 1933 Act has been to prevent such disclosure prior to the prospective purchasers' receiving the entire story in the legislatively mandated prospectus.")

[110] *See* Regulation of Takeovers and Security Holder Communications, SEC Release No. 33-7760 (October 22, 1999), https://www.sec.gov/rules/final/33-7760.htm.

[111] In the Matter of Carl M. Loeb, Rhoades & Co. (1959).

[112] *Id.* at 202.

[113] *Id.*

[114] *See* 17 C.F.R. § 230.167.

Gun-jumping rules carry real bite. In June 2011, Groupon, Inc. filed a registration statement for its proposed IPO, and was met with some skepticism over its use of a non-GAAP accounting metric and business model.[115] In August, Groupon's CEO and co-founder sent an email to employees containing a strident defense of the business. Groupon's IPO was delayed and the SEC required Groupon to include the email as an appendix to the prospectus, thus assuming liability for its contents.

These restrictions apply not only to official corporate communications, but also advertisements and pieces in the popular press. *Playboy Magazine* ran an article titled "Google Guys" during Google's quiet period. The article ran months later, and the market speculated that the SEC would impose a "cooling off" period on the company—that is, delay its IPO—even though the company had no input in the timing of the article.[116] Like Groupon, the SEC forced Google to include the magazine article in an appendix.[117] Salesforce.com's IPO was delayed after its CEO told a reporter "The SEC prohibits me from making any statements that would hype my IPO."[118]

The SEC distinguishes between "purely factual" disclosures, which are less likely to condition the market, and disclosures that make forecasts, projections, or predictions ("soft information").[119] Readers may recall that SPACs allow for just this type of forward-looking information.

Carefully delineated safe harbors to the gun-jumping rules allow for certain disclosures—for example, communications prior to 30 days before the filing of the first S-1 are presumed not to be gun-jumping so long as the words do not mention the offering.[120] These safe harbors have lessened the bite of gun-jumping rules, as have provisions for "testing the waters" before an offering.[121] Still, violations trigger liability under Section 12, with a right of rescission or damages.[122] More importantly for our purposes, they continue to constrain what can be said publicly about a private firm as it moves toward public-company status. Traditional IPOs treat this period, which spans from when a company first contemplates going public up through the

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[115] Eric Saviz, *Groupon Finds Accounting Issues; Restates Q4; SHrs Plunge (Updated)*, FORBES (Mar. 30, 2012, 5:10 PM).

[116] Dawn Kawamoto, *Google Says Playboy Article Could Be Costly*, CNET (Aug. 19, 2004, 12:01 PM).

[117] *See id*.

[118] *See* Lauri J. Flynn & Andrew Ross Sorkin, *Salesforce.com Is Said to Delay Its Public Offering*, N.Y. TIMES (May 19, 2004).

[119] *See* Carl W. Schneider, *Nits, Grits, and Soft Information in SEC Filings*, 121 U. PA. L. REV. 254 (1972); *see also* Joel Seligman, *The SEC's Unfinished Soft Information Revolution*, 63 FORDHAM L. REV. 1953 (1995).

[120] 17 C.F.R. § 230.163A. The issuer must also take "reasonable steps" to prevent further distribution of the information during the 30-day period. Moreover, once a company has achieved the status a well-known seasoned issuer (WKSI), it has considerably more freedom when conducting secondary offerings. Rule 168 creates a safe harbor for companies already reporting under the Exchange Act to provide this information, as long as the issuer had previously released the same type of information in the ordinary course of business and in the same "timing, manner and form." Rule 169 applies to non-reporting companies—among them, private companies looking to go public—the same general safe harbor for types of factual information that the issuer had released in the past, but does *not* allow for forward-looking or soft information.

[121] *See generally* Jeffrey A. Brill, Note, *"Testing the Waters" – The SEC's Feet Go from Wet to Cold*, 83 CORNELL L. REV. 464 (1997).

[122] *Id*. at 197 n.39, 199 n.54.

IPO itself, as a fraught time where information must be carefully controlled and offers of any kind, much less commitments to buy, may not be made. This constraint—and why it exists—it has great relevance to the modern SPAC experiment. Gun-jumping rules formed a key focus of the '33 Act, and it is to that history that we now turn.

B. History and Context of the '33 Act

The reader may be forgiven for a desire to move to the topic of SPACs. But SPACs are a form which looks prospects look dim, in the U.S., at least. What concerns us most is what SPACs tell us about the going-public process, and how it might be improved. One more piece of context remains necessary. Now that we have reviewed the *what* of gun-jumping, it remains to turn to the *why*—why securities laws place such an emphasis on controlling the flow of information and funneling it through SEC filings. The answer has everything to do with a desire to tamp down investor exuberance and to enforce underwriter-syndicate control of the time and price of the offering.

Some context for the '33 Act is in order. By the 1920s, underwriting banks had evolved into a syndicate system to spread the risk and share in the offering efforts, a function that underwriter syndicates continue to serve to this day.[123] Just as now, all the banks in the syndicate were supposed to coordinate to sell an issuer's securities at the same price and at the same time, when the managing underwriter gave the word.[124] The primary purchasers of IPOs were institutions and wealthy individuals; retail investors were not major participants in these markets.[125]

This syndicate system came under increasing pressure in the wake of WWI, in an ensuing move to popularize the stock market. The need to finance U.S. war efforts in the first truly global war led to the marketing and distribution of millions of dollars of Liberty bonds.[126] This successful sales campaign was the product of a new effort to market the bonds to the masses.[127] As historian and legal scholar of the period Paul Mahoney writes, "In the course of tapping this new market, many investment banks got their first taste of what could be accomplished with "high-pressure" selling effort."[128]

After the war, this network turned its "high-pressure" sales tactics and retail-investment focus to selling not bonds, but stock issuances to the general public.[129] Techniques for reaching the retail market included using newspaper and radio advertising, and door-to-door securities sales.[130] A number of new banks emerged on the scene, now that success did not depend on

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[123] Mahoney, *supra* note 54.

[124] *Id*.

[125] *Id*. at 5.

[126] *Id.* at 6–7.

[127] *Id.* at 6 ("To sell bonds on such a scale, the Treasury and listed the country's commercial and investment banks and brokerage houses in a nationwide sales drive. These institutions sold bonds in small denominations and solicited millions of individuals of modest means who had never before invested in securities.").

[128] *Id.*

[129] *Id.*

[130] *Id*. at 7.

years-long investments in reputation and contacts.[131] These commercial-bank salesmen, new as they were to the sale of stock, were all too willing to break ranks by selling sometimes-questionable securities ahead of the managing underwriters' greenlight (called "beating the gun") and by selling at a discount.[132]

Beating the gun became common by the late 1920s. Before this time, each bank in the syndicate committed not to sell securities until the managing underwriter "released" them through a telegram or telephone call.[133] Beating the gun meant taking orders early, thus getting a "head start" on the competition in the retail market.[134] The syndicate's first response to this burgeoning problem was to try "to keep the timing and price of the issue secret until the last minute."[135] But this was difficult when "companies were closely followed by the financial press, and newspapers or investment magazines might print the details of a coming large issue of securities before the issuing house had formally released the information to the syndicates."[136] When both salesmen and customers knew the offering details from their daily newspaper, early sales were difficult to prevent. The need for controlling the flow of information to the public was becoming clear—because the banks could not control themselves.

The Crash of '29 brought to light dubious stock issuances and stock practices. Congress was concerned that the public was buying the stock of new companies based on news reports, rumors, and speculation, propelled forward by pressure from unscrupulous brokers and with little reliable information at hand.[137] In response to these concerns about sales tactics and lack of information, the 1933 Act took the English Companies Act as a model,[138] but introduced a revolutionary innovation.

The English Companies Act's theory—one endorsed by President Franklin D. Roosevelt in the wake of the Crash—was one of disclosure-based, rather than merit-based, regulation.[139] But there was a crucial difference in the U.S. implementation of the disclosure-based approach. The English Companies Act allowed an issuer's stock to trade as soon as the company disclosed information about itself.[140] The '33 Act fundamentally changed this model by *delaying* trading until information about a new issuer had a chance to accumulate. Thus, the Act created a waiting period, one comprised of two components: 1) a prohibition on pre-listing trading and 2) tight controls on publicity efforts leading up to the IPO. These two characteristics still feature in traditional IPOs today but, as we will see, SPACs dispense with them. To understand the ramifications of this change, we will look at each in turn.

First, the ban on sales. The 1933 Act made it illegal to sell securities before the effective

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[131] *Id*. at 8.
[132] *Id*. at 14.
[133] *Id*. at 14.
[134] *Id*.
[135] *Id*. at 14–15.
[136] *Id*. at 15.
[137] James M. Landis, *Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29, 30–35 (1959).
[138] *Id.* at 34
[139] *Id*.
[140] *Id.*

date—no sale could occur until after the SEC had blessed the issuer's public filings. This move was nothing short of revolutionary. As recounted by James Landis, one of the '33 Act's authors, the "novel" waiting period served four distinct functions: 1) It reduced the ability of the managing underwriter to pressure the syndicate to take an allotment of shares "sight unseen"; 2) It let the financial markets learn about the basic data underlying the issuance and gave both the public and independent dealers an idea of its quality; 3) It empowered the SEC to prevent issuances with inadequate or false data from reaching the market; and 4) It gave underwriters some reassurance that the SEC would not halt trading after it began when concerns developed, leaving them with "bundles of legally unsalable securities on their shelves."[141]

A competing bill took the opposite approach, providing that the registration took effect immediately upon the filing of the registration statement but that the Commission had the power to revoke registration on the basis of inadequacy of the filing, misrepresentation, fraud, or the unsoundness of the security.[142] This rejected retroactive approach would have given a species of remedy to defrauded investors, but one that suffered from the horse already being out of the barn—investors had already lost money, and rendering the security untradable merely added salt to their wounds.[143] The 1933 Act's key innovation was the introduction of a delay between disclosure and trading, converting the SEC from policeman to driver's-license-test administrator. Without the SEC's blessing of its disclosure, the issuer simply could not legally access the public markets. And, of course, the underwriters served as a second gatekeeper, because issuers required their signoff before listing as well.

But the 1933 Act does not only prohibit committing to sell or buy until there is an effective registration statement; it even prohibits *offers* to buy or sell stock to the public until certain requirements are met.[144] This is the "quiet period" of the modern IPO, and its roots, as Paul Mahoney explains, stemmed from the failure of underwriters in the pre-1933 period to prevent lower-level salesmen from selling in advance of the initial offering. Remember that the syndicate system—where the underwriter released the offering at a set time and at a uniform price—faced increased pressure in the post-WWI period. The perception was that that "preoffering publicity"—by way of newspaper stories and phone-call campaigns—was enabling salesmen to "beat the gun" and make binding offers to sell in advance of the underwriter's release of the securities for sale.[145] Even if the underwriter had not yet officially settled on a price, excited investors were nevertheless willing to commit because the newspapers were providing all the details of the offering.[146] So the 1933 Act not only forbids outright *selling* before the registration statement is effective; it also controls how and when details about the offering can emerge by imposing a quiet period that begins before the issuer even files IPO paperwork with the SEC. Controlling information in this fashion was intended to prevent the sort of false starts that attended the pre-1933 Act period.[147]

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[141] *Id.* at 35. This last concern was a real risk because issuances took days or months to sell, and the traditional approach would subject underwriters and investors alike to the risk of being stuck with delisted securities. *Id.* at 32.

[142] *Id.*

[143] *Id.*

[144] *Id.* at 198.

[145] Mahoney, *supra* note 54, at 14.

[146] *Id.* at 15.

[147] "Legal formalities come at the end to record prior understandings, but it is the procedures by which these prior understandings, embodying investment decisions, are obtained or generated which the Securities Act was

Thus, the intent of the 1933 Act was to create a waiting period, where the public would learn about a company preparing to go public over time. All communications about the company funneled through official filings, with any alternate avenues of information, notably through the press, strictly constrained. And no sales, or even offers of sale, could occur unless and until the registration statement was declared effective, in order to allow underwriters to hold the line and prevent pre-selling. Over the years, the SEC affirmed that a capacious understanding of the definition of offer was needed to accomplish the '33 Act's statutory purpose.[148]

Thus, the guiding principles of the '33 Act: 1) the underwriting investment bank serves as the gatekeeper for offerings and establishes the price; 2) there can be no sales before the offering documents are effective, and 3) even offers to sell are prohibited before a registration statement is on file with the SEC. With these rules, and their background principle of fearfulness for the vulnerabilities of the retail investor firmly in mind, we can turn to SPACs.

IV. SPACs' CHALLENGE TO THE TRADITIONAL IPO

Having reviewed the conventional IPO process, and the content and raison d'etre of gun-jumping rules in detail, the reader is now ready to appreciate the innovation that SPACs represent. SPACs cleverly follow the IPO rules while subverting their function, as Section A describes. The result, Section B argues, is a new kind of public offering.

A. SPAC IPOs

SPACs begin with a sponsor—who receives 20% of the SPAC—if, and only if, it completes an acquisition.[149] The sponsor then works with an investment bank to sell the SPAC shares to the public through an initial public offering. Part II described the rigors of the IPO in detail, and the reader knows that the process itself is quite grueling because it entails disclosing a great deal of information to the public for the first time, and the bank and the company face considerable liability if they mislead the public.

A SPAC dutifully goes through the traditional IPO process,[150] but a SPAC IPO is comparatively painless because it has little to disclose at IPO. The drafting of the registration statement is a relatively easy affair. No details regarding the SPAC's operating history or current operations are necessary—the firm has no operations at all at this point.[151] It is merely a shell.[152]

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intended to reform." In the Matter of Carl M. Loeb, Rhoades & Co., S.E.C. Release No. 5870(Feb. 9, 1959).

[148] *Id.*

[149] *See, e.g.*, Jeff Reeves, *The SPAC List: 10 Dealmakers to Watch*, KIPLINGER (April 13, 2021), https://www.kiplinger.com/investing/stocks/ipos/602601/spacs-list-dealmakers-to-watch; *see also* Elana Dure, *Top Performing SPACs of 2020*, INVESTOPEDIA (Dec. 30, 2020), https://www.investopedia.com/top-performing-spacs-of-2020-5093918; Vince Martin, *The Top 10 SPAC IPOs of the Last Year*, INVESTORPLACE (Jun 12, 2020, 11:20 AM), https://investorplace.com/2020/06/top-10-spac-ipos-last-year/.

[150] SU, *supra* note 4, at 1.

[151] Daniel S. Riemer, *Special Purpose Acquisition Companies: SPAC and Span, or Blank Check Redux?*, 85 WASH. U. L. REV. 931, 933 & n.11 (describing the emptiness of a SPAC).

[152] Rodrigues & Stegemoller, *supra* note xxx, at 871.

It essentially asks investors to give it money for a future, as-yet-unidentified acquisition.

At IPO, a SPAC sells *units*, a hybrid security consisting of two components—one share of common stock and one warrant. Pricing a SPAC also requires no expertise in valuation as compared to the arduous book-building process for a traditional IPO because, by convention, the offering's price is merely the amount set to be raised divided by the shares issued, calculated mechanically to arrive at $10 per unit.[153]

The sponsor places the proceeds from the IPO into an escrow account, where it is invested in government-backed securities and earns a small amount of interest.[154] The sponsors then embark on a hunt for a likely target.[155] The SPAC shareholders are investing in the unknown, trusting in the skill of the SPAC managers to find a good target. This may feel risky—and, indeed, is—but the SPAC form crucially seeks to reassure its shareholders with the fail-safe protection of a redemption right.[156]

SPAC shareholders have the right to redeem their shares, taking back their share of the trust account—usually around $10 per share because of the money that the sponsors have contributed.[157] The certificate of incorporation provides that they can exercise this redemption right under two circumstances: just before the merger is accomplished, or if the SPAC fails to find a target and its shelf life expires.[158]

Theoretically, at least, the value of the common stock has a floor equal to the redemption price, which is the price paid for the unit (again, usually $10). In practice, the price of some SPACs dips below $10 per share—never more than a few cents, presumably because of a discount for the time value of money, in this case the cost of waiting for a redemption or liquidation event.

This is another key feature of SPACs: they are time-bound. SPAC managers do not have an unlimited amount of time to search for a likely target. Initially, SPACs lasted two years; in our sample, the average SPAC allows for 24 months for completion, although the median—22 months—is somewhat lower than this deadline because a number of SPACs only allow for 18 months to close a deal.

In short, the SPAC organizers basically offer this promise to their shareholders: give us your money for a limited time, and we'll search for a target. Once we find one, you can stay with us or get your money back. And if we don't find a target, you get your money back then, too.

Now, a reader would be forgiven for assuming that the money being held in the trust account would go to fund the eventual acquisition if it takes place. That used to be the case. But in

[153] *See infra* at Part I.C.1. After the IPO, the warrant and stock decouple and can then be traded separately. The accompanying warrants are a form of option exercisable, typically at $11.50, if and only if the SPAC acquires a target.

[154] Rodrigues & Stegemoller, *supra* note xxx, at 854.

[155] *See* Klausner et al., *supra* note 39, at 6–7.

[156] *See id.* at 14.

[157] *See infra* Part IV.B. (showing price converging at $10 per share).

[158] Klausner et al., *supra* note 39, at 14–16.

SPACs today, shareholders can vote yes for a merger *but still* redeem their shares—a point that our companion paper discusses at length.[159] Keep in mind for now that the redemption right provides a species of guarantee, a floor below which the value of a SPAC share should not fall very far.

With these ground rules in place, the SPAC managers begin their time-limited hunt for an acquisition. Once they identify one, negotiations begin. If these bear fruit, then the SPAC announces the proposed acquisition. It makes public disclosures explaining the business combination and the process whereby shareholders will vote to approve or reject the transaction.[160] If the SPAC obtains the necessary shareholder vote (as it does in every case in our sample), the private company merges with the public SPAC shell and begins trading, usually under a new trading symbol. If the SPAC fails to identify a target or conclude a deal within the time specified in the IPO, then the shareholders receive their escrowed money back and the sponsors receive nothing.[161]

B. SPACs and the De Facto Elimination of the Quiet Period

We can now begin to put together the pieces we have assembled and appreciate the radical change that SPACs offer. Many articles, in the popular press and academia alike, focus on a de-SPAC's differences from the traditional IPO.[162] Notably, investment banks face much less liability in the de-SPAC than in a traditional IPO, since Section 11 liability did not attach to the underwriters.[163] Notably, the SEC's proposed rules seeks to eliminate this difference, and assign Section 11 liability to underwriters and other de-SPAC participants—and have therefore caused many investment banks to flee the market.[164] Secondly, a target can make forecasts with a SPAC in a way they typically cannot in a traditional IPO.[165] Again, the SEC is seeking to

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[159] Usha R. Rodrigues & Michael Stegemoller, *Redeeming SPACs* (on file with the authors) [hereinafter Rodrigues & Stegemoller, *Redeeming SPACs*].

[160] Sean Donahue, Jeffrey Letalien & Brian Soares, *Going Public through a SPAC: Current Issues for SPAC Sponsors and Private Companies*, MORGAN LEWIS (Dec. 2, 2020), https://www.morganlewis.com/-/media/files/publication/presentation/webinar/2020/morganlewisgpcaspacpresentation12022020.pdf; *see also* Mira Ganor, *The Case for Non-Binary, Contingent, Shareholder Action*, 23 U. PA. J. BUS. L. 390, 409–16. (2020)

[161] Viany Data, Ekaterina Emm & Ufuk Ince, *Going Public Through the Back Door: A Comparative Analysis of SPACs and IPOs*, 4 BANKING & FIN. REV. 17, 19 (2012).

[162] John Coates, *SPAC Law and Myths* (2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4022809; Michael Dambra, Omri Even-Tov & Kimberlyn George, *Should SPAC Forecasts be Sacked?* (2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3933037; Yunpeng (Patrick) Xiong, *SPACs and Direct Listings: The Death Knell for Traditional IPOs?*, CALIF. L. REV. BLOG (Apr. 2021), https://www.californialawreview.org/spacs-and-direct-listings-the-death-knell-for-traditional-ipos/; *Understanding SPAC IPOs Versus Traditional IPOs*, WOODRUFF SAWYER, https://woodruffsawyer.com/industries/spacs/spac-ipos-traditional-ipos-difference (last visited Feb. 21, 2022).

[163] *See* 15 U.S.C. § 77k. Section 11 of the 1933 Act puts the underwriter "on the hook"—that is, subjects it to strict liability—for fraud in the sale of the securities and in the registration statement that describes the firm's business and the offering. Investment banks share liability with the issuer for statements made in the offering documents and for violations that occur in the process of a traditional public offering. *See* Coates, *supra* note 32.

[164] https://www.bloomberg.com/news/articles/2022-04-04/citi-said-to-pause-new-spac-issuance-as-sec-signals-crackdown.

[165] The SEC recently suggested that the PSLRA's forward-looking statements safe harbor might not apply to SPAC acquisitions. *See* Public Statement, John Coates, *SPACs, IPOs and Liability Risk Under the Securities Laws* (Apr. 8, 2021), https://www.sec.gov/news/public-statement/spacs-ipos-liability-risk-under-securities-laws.

eliminate this distinction by explicitly providing that the safe harbor that SPACs claim for forward-looking statements does not apply.

These are important differences, to be sure—indeed, we write about them in our companion article, *Redeeming SPACs*. They reflect real divergences in how IPOs and de-SPACs are treated: IPOs are subject to one (stricter) set of rules, and the de-SPAC, a functional equivalent of the IPO, are subject to another (looser) set of rules. But these differences are not the focus of this Article. Our thesis is that even with these elements leveled—that is, even if we lessen Section 11 liability at the IPO to equal that of the de-SPAC, or even if we forbid forward projections at the de-SPAC in order to mirror the rules for IPOs—de-SPACs represent a fundamental change to the IPO process. And this change has the potential to create a valuable alternative to the traditional IPO—if the SEC were to change course in two important ways. These are to refrain from imposing Section 11 liability at the de-SPAC; and to institute a maximum-redemption threshold on SPACs. We will explain both recommendations in Part VI, but the first step is to make a case for SPACs' intrinsic value.

As a reminder, the innovation of the 1933 Act was the introduction of the waiting period, a delay that allows disclosure of the not-yet-public company's information over time *before* trading begins. The public cannot trade unless and until the SEC has determined that the accumulated disclosures pass muster. Along the way (and a long way it is), the public has the chance to assimilate that information as a whole. Moreover, the underwriting bank is able to organize a pricing mechanism that takes into consideration, in orderly fashion, informed investors' indications of interest with respect to the value of the firm.

Now for SPACs. Once public, the SPAC identifies a likely target firm and negotiates a transaction. Upon closing, that target effectively goes public, i.e., becomes a publicly traded firm.[166] But the target debuts on the public markets without the constraints of the traditional IPO.[167] SPACs dispense with the '33 Act's waiting period, since trading on the information of the private target occurs as soon as rumors of a deal reaches the public markets. Gun-jumping rules do not apply, so the press can feature information about the target without risk of delaying the offering.[168]

To appreciate this change, let's examine more closely what happens in a de-SPAC. After IPO, a SPAC stock trades, typically at around $10 a share. It dutifully files quarterly and annual reports with the SEC, but there isn't really anything to report except how much interest the money in the trust account is earning. Then comes an announcement, accompanied by an investor presentation, typically on a form 8-K: the SPAC has made a deal with a target! Subsequently, the SPAC files an S-4 or proxy statement, describing the deal in more detail. Additional investment, in the form of a private investment in public equity (PIPE), may be announced.[169] And *all the while, the SPAC stock is trading on the market*.

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[166] *Id.*

[167] *Id.* (explaining that SPAC IPOs are face less regulatory security because they do not have business operations just yet).

[168] Gun-jumping rules do apply in mergers, but they have to do with anti-competitive behavior. *See* Michael C. Naughton, *Gun-Jumping and Premerger Information Exchange: Counseling the Harder Questions*, 20 ANTITRUST 66, 66–67 (2006).

[169] Marketing material will be filed with the SEC because of Regulation Fair Disclosure (Reg FD), which

By now, the reader can appreciate the importance of this change. In an IPO, the underwriting bank sets the price, based on a book-building process and an indirect price discovery by way of asking institutional investors and favored clients about their interest in the offering. As we have seen, almost invariably, underpricing occurs. With a SPAC, rather than an investment bank interpolating itself between the company and institutional investors, pricing of the still-private firm is driven by the market itself—and it continually fluctuates as that market receives new information.

There are, of course, drawbacks to this new market—and to understand those, we can certainly use pre-1933 Act history as a guide, with its concern about protecting vulnerable investors. The '33 Act allowed the SEC to prevent harm ex ante, rather than to seek to punish wrongdoers ex post. It tightly controlled the kind of information the public learned about the still-private issuer as well as the manner in which that information was distributed—largely by funneling it to the registration statement.

The DWAC/TMTG transaction serves as a salient example of how these investor concerns play out today. Exhibit 1 provides an illustration, through the Digital World acquisition of Trump Media, of how publicly released information about the still-private target is impounded into the price of the SPAC prior to the de-SPAC. DWAC launched its IPO at $10 on September 9, 2021. On October 20, it closed at $9.96, after which it announced plans to merge with Trump Media/Technology Group. The next day, DWAC closed at $45.50. On October 22, it closed at $94.20.[170] On October 29, the *New York Times* reported that the SEC was investigating whether DWAC's prospectus misstated the truth in asserting that it was not in talks, direct or indirect, with potential targets in September.[171] Any such investigation would jeopardize the proposed merger. Subsequently, Senator Elizabeth Warren urged investigation, and on December 6, DWAC announced that the SEC and FINRA were investigating. [172]

But it was not all bad news for the company. On December 4, DWAC announced that it had obtained $1 billion in PIPE funding from undisclosed investors,[173] and on December 6 that congressman Devin Nunes would be TMTG's CEO.[174] December 6 filings also revealed the

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requires that when a public firm discloses material nonpublic information to certain persons, the company must simultaneously disclose that information to the public.

[170] Bernard Zamboni, *Here is Why DWAC Stock May Be Seriously Undervalued*, STREET (Jan. 19, 2022), https://www.thestreet.com/memestocks/other-memes/here-is-why-dwac-stock-may-be-seriously-undervalued.

[171] Matthew Goldstein, Lauren Hirsch & David Enrich, *Trump's $300 Million SPAC Deal May Have Skirted Securities Laws*, N.Y. TIMES (Oct. 29, 2021), https://www.nytimes.com/2021/10/29/business/trump-spac-digital-world.html?searchResultPosition=9.

[172] Dan Mangan, *Sen. Elizabeth Warren Calls on SEC to Investigate Trump SPAC Deal with DWAC for Possible Securities Violations*, CNBC (Nov. 18, 2021, 10:24 AM), https://www.cnbc.com/2021/11/18/sen-elizabeth-warren-calls-on-sec-to-investigate-trump-spac-deal.html; Digital World Acquisition Corp., Current Report (Form 8-K) (Dec. 4, 2021).E**rror! Hyperlink reference not valid.**

[173] *Trump Media & Technology Group Corp. and Digital World Acquisition Corp. Announce $1 Billion "PIPE" Investment in Committed Capital to Fund Business*, GLOBENEWSWIRE (Dec. 4, 2021, 12:35 PM), https://www.globenewswire.com/news-release/2021/12/04/2346139/0/en/Trump-Media-Technology-Group-Corp-and-Digital-World-Acquisition-Corp-Announce-1-Billion-PIPE-Investment-in-Committed-Capital-to-Fund-Business.html.

[174] Kevin Breuniger, *GOP Rep. Devin Nunes Resigns from Congress to Become CEO of Trump's Media*

terms of the PIPE, as well as a PowerPoint presentation made to potential PIPE investors back in November that contained key details about TMTG.[175]

Each of these filings and pieces of information received considerable attention from financial analysts and the press. Pundits and commentators (including ourselves) dissected the terms of the PIPE, poring over all available information. And so did the markets. During this period, the stock traded from a high of $72.76 to $57.85. Some investors profited as a result of this volatility… and some lost.

This trading history illustrates the perils that can confront retail shareholders investing in SPACs. Over a 6-week period, the market learned important news about the upcoming merger and fledgling company again and again. In contrast, the failed WeWork IPO featured a pattern of information flow similar in some ways to TMTG's. The public received information in bursts and processed it as it was made public. But there was no simultaneous market available for the stock of WeWork. No stock traded hands while information about the company became public. So even as the hype and excitement predating its public S-1 filing turned to scorn and ridicule, there were no investors—at least, no public investors—left holding the bag.

The DWAC SPAC may not be the best illustration of the market that SPACs provide for information about a still-private issuer, because the market reacted not only to information about the target TMTG, but also about DWAC itself—that is, the SPAC itself. Typically, the SPAC is a mere shell, about which no relevant information emerges that is not also fundamentally important for the target, making the post-announcement SPAC trading a referendum solely on the value of the target. DWAC's early missteps, which triggered SEC investigation, set it apart from the usual empty-shell company. So let's consider two other examples.

Social Capital Hedosophia Holdings Corp. IPO'd in 2017 at $10 per share, and continued trading at around that level until it announced in July of 2019 that it would merge with Virgin Galactic, at which point the stock price jumped.[176] On October 8, the SPAC announced that Boeing would invest $20 million in Virgin Galactic, and the stock jumped again.[177] The same SPAC sponsor, known in the press as the "SPAC King", organized another SPAC, Social Capital Hedosophia Holdings Corp. II, which merged with OpenDoor.[178] That announcement sparked an increase of 34.7% in the stock price.[179]

In another example, Churchill Capital Corp. IV IPO'd on July 30, 2020 for $10 per share.[180]

Company, CNBC (Dec. 6, 2021, 5:08 PM), https://www.cnbc.com/2021/12/06/gop-rep-devin-nunes-resigns-from-congress-to-become-ceo-of-trumps-media-company.html.

[175] Digital World Acquisition Corp., Current Report (Form 8-K) (Dec. 4, 2021).

[176] Jon Sindreu, *Virgin Galactic's Quest Could Get Bumpier*, WALL ST. J. (Oct. 28, 2019, 1:36 PM), https://www.wsj.com/articles/virgin-galactics-quest-could-get-bumpier-11572284206?mod=article_inline.

[177] *Id.*

[178] Matthew Frankel, *Here's Why Opendoor Acquirer Social Capital Hedosophia Holdings II Is Soaring Today*, MOTLEY FOOL (Dec. 7, 2020), https://www.fool.com/investing/2020/12/07/heres-why-opendoor-acquirer-social-capital-hedosop/.

[179] Leslie Picker, *Palihapitiya Finds Next '10x Idea' with $4.8 Billion SPAC Deal for Real Estate Start-Up Opendoor*, CNBC (Sept. 15, 2020, 7:55 AM), https://www.cnbc.com/2020/09/15/palihapitiya-finds-next-10x-idea-with-4point8-billion-spac-deal-for-real-estate-start-up-opendoor.html.

[180] *Churchill Capital Corp IV Announces Pricing of $1.80 Billion Initial Public Offering*, PR NEWSWIRE (July

On January 12, 2021, its CEO, Klein, was asked about a potential merger with Lucid, an electric-vehicle startup.[181] He declined to comment, and in the subsequent weeks, the stock price rose from $14.15 to a height of $64.86 on February 18, 2021. This high volatility indicates the risk inherent in the SPAC market—speculative trading can play out against a backdrop of asymmetric information and possibly even insider trading. It is clear that at least some market participants knew—or thought they knew—that a deal was in the works. On February 22, 2021, Lucid and Churchill announced entry into a definitive merger agreement.[182] Churchill's shares closed at $57.37.[183] In the following days, the price sank to $30.75.[184] On July 26, 2021, the date of the merger, the closing price was $26.83.[185] The reader gets the idea. SPACs provide a real-time market for information about private targets, which unfolds as that information trickles out.

Markets contain participants that win and lose. And the SPAC market plays out against a backdrop of unusual information asymmetry, which could unfairly allocate the winners and losers. The retail investor lacks the protection of accumulated disclosure—she must assess each piece of information on the still-private company as it becomes public and, particularly if we believe investor hysteria is an inevitable companion of new offerings, she risks getting swept up in the early buzz and buying in before more negative information comes to light.

The questions then become: How risky is such a market? How much risk does it expose retail investors to? And is there any way to mitigate any unnecessary risk? If the risk level is knowingly and willingly accepted by investors, then SPACs provide two benefits, both linked to the partial disintermediation of the IPO. For retail investors, SPACs provide the ability to invest in private companies without needing to be among the lucky few favored by the underwriting banks. For would-be-public companies, SPACs bypass the investment banks' gatekeeping role and allow the companies to make their case more directly to the public markets.

V. THE SPAC MARKET

These examples suffice to illustrate the market for information of still-private companies that SPACs create. Having established the existence of this new market, though, the next question is whether it is a market worth having. Given the securities' laws animating concern about protecting retail investors, especially amid the heightened concern regarding investor hysteria in a new offering, the characteristics of this new market are vitally important. We present here data that describe the market generally, and then describe first its liquidity and second its returns to SPAC investors. The second question is the most important, but understanding the first—the liquidity of this new market—is crucial to situating the data with respect to investor profits.

30, 2020, 7:00 AM), https://www.prnewswire.com/news-releases/churchill-capital-corp-iv-announces-pricing-of-1-80-billion-initial-public-offering-301102827.html.

[181] Rohail Saleem, *Lucid Motors and the SPAC Churchill Capital Corp. IV (CCIV) Are Now Much More Likely to Merge in Light of New Circumstantial Evidence*, WCCFTECH (Jan. 13, 2021, 9:23 AM), https://wccftech.com/lucid-motors-and-the-spac-churchill-capital-corp-iv-cciv-are-now-much-more-likely-to-merge-in-light-of-new-circumstantial-evidence/.

[182] Churchill Capital Corp. IV, Current Report (Form 8-K) (Feb. 22, 2021).

[183] *Churchill Capital Corp IV Stock Price (Quote)*, STOCKINVEST.US, https://stockinvest.us/stock-price/CCIV?page=3 (last checked February 26, 2022).

[184] *Id.*

[185] *Id.*

A. Descriptive Statistics

We turn to empirical data on a broader sample of firms to examine certain features of this new market. The first is liquidity and volatility; the second is returns to investors. Our sample includes all SPACs that attempted to undertake an IPO from January 1, 2010, to December 31, 2019. We use FactSet, EDGAR filings, Nexis Uni and CRSP to acquire price, volume, trading, shares outstanding, and SPAC firm-level characteristics. Ending our sample by December 31, 2019 gives each SPAC sufficient time to complete the typical contractual two-year term allotted to search for a target. As of January 2022, there are eight firms in our sample with an uncertain final outcome: six have announced, but not completed, a deal and two others completed their IPO in July of 2019 but have yet to announce a transaction.

More specifically, we use the following procedure to construct our sample. We use Nexis Uni to search for EDGAR filings with an SIC code of 6770, the code for blank check companies, of which SPACs are a subset.[186] This word-search procedure produces 264 results, from which we exclude both 1) firms subject to Rule 419, and thus by definition not SPACs,[187] and 2) firms that are now operating companies but somehow retain the 6770 SIC due to a past transaction involving a SPAC. These screens produce a sample of 241 firms that file an S-1 as a blank-check company from 2010 to 2019 and, from these, 216 effect an IPO.

Table 1 shows some of the important characteristics of our sample. Most SPACs occur in the last three years of our sample, when the form surged in popularity. We focus only on SPACs that acquire a target and, as one can see in Column (3) of Panel A, 127 of the 188 firms that completed an acquisition began the SPAC process in the 2017–2019 period. Our sample consists of $43.8 billion in IPO proceeds raised by firms that ultimately acquire targets worth, in aggregate, $206 billion. Panel A also shows the move of SPAC IPOs from a relatively unknown listing on the OTC in the first two years (2010 and 2011) to almost exclusively being listed on the NYSE and Nasdaq in the later years.

Panel B of Table 1 details the basic characteristics of SPACs. The median SPAC raised $175 million in the IPO, although there is a wide variance of $16.5 to $900 million in IPO proceeds over this period. While there are some exceptions, most SPACS (shown in the median) exhibit a unit price of $10, which includes one warrant, with an exercise price of $11.50, coupled with one share of common stock. Moreover, SPACs generally are allowed 24 months to find a target, pay out 5.5% of the IPO proceeds as an underwriting fee (though most of this is deferred), and

[186] We rely on Nexis Uni because an EDGAR search leaves out valid transactions since the SEC reclassifies the SPAC SIC into the SIC of the target after acquisition. For example, Social Capital Hedosophia Holdings Corp. was a blank-check company with SIC code 6770 until it acquired Virgin Galactic Holdings, Inc. After the acquisition, the name of the SPAC became the target's name and is reclassified under Transportation Services (SIC 4700). We add the restriction that "6770" must be near the term "Standard", which will appear in the phrase "Primary Standard Industrial Classification Code Number." Our search also eliminates "commodity pools" from the final sample.

[187] Rule 419 defines a "blank check" company as one that is both issuing penny stock and "Is a development stage company that has no specific business plan or purpose or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies, or other entity or person." SPACs avoid being penny stock by having a market value of over $5 million.

deposit 100% of the proceeds in a trust to await potential redemption.

Table 1. Descriptive Statistics for SPACs that File Their Initial Prospectus from 2010 to 2019

Panel A of this table displays our sample firms by the year they file their original S-1. Column (2) shows the number of S-1s filed per year. Columns (3) and (4) display the number of SPACs from column (2) that accomplish an IPO and complete the de-SPAC process, respectively. Column (5) is column (4) scaled by column (2). Column (6) the total amount of proceeds raised for all SPACs, where proceeds is the sum of IPO offering proceeds and the amount raised in the private placement occurring simultaneous to the IPO. The mean amount paid for the target in the de-SPAC is shown in column (7). Columns (8) – (10) show the percentage of firms that IPO on the OTCBB, Nasdaq, and NYSE, respectively. In 2018 there was one listing on the NYSE American exchange, which appears in the OTCBB column. In Panel B, *IPO offering proceeds* is the product of the number of units and the price per unit offered in the IPO. *Unit price* is the price paid for one unit of the SPAC at the IPO. *Warrants per unit* is the number of warrants contained in each unit. *Warrant strike price* is the price the warrant holder must pay to obtain a share if exercising his unit. *Maximum months allowed for acquisition* is the number of months stated in the IPO prospectus that the SPAC has to close an acquisition. *% of offering proceeds in trust* is the amount of cash held in trust scaled by the amount raised in the IPO. *Gross underwriter discount* is the proportion of the IPO proceeds paid to the underwriter(s) in the IPO.

Panel A. SPACs by year of initial S-1 filing

(1)	(2) # of SPACs with initial S-1 filing	(3) SPACs in column (2) that IPO	(4) SPACs in column (2) that compl. acqu.	(5) % of initial filings that compl. acq.	(6) Total proc. at IPO ($mil)	(7) Total value paid for targets ($mil)	(8) Listed on OTCBB	(9) Listed on Nasdaq	(10) Listed on NYSE
2010	7	6	3	42.9%	$548.8	$1,499.3	83.3%	16.7%	0%
2011	22	15	12	54.5%	$1,083.6	$6,065.2	46.7%	53.3%	0%
2012	2	0	0	0.0%	$0.0	$0.0	0%	0%	0%
2013	12	12	9	75.0%	$1,538.6	$3,552.5	8.3%	91.7%	0%
2014	15	14	10	66.7%	$2,148.2	$6,484.8	0%	100.0%	0%
2015	21	16	14	66.7%	$3,090.4	$13,793.4	0%	100.0%	0%
2016	18	14	13	72.2%	$3,706.4	$10,029.4	0%	100.0%	0%
2017	37	37	34	91.9%	$9,982.2	$33,537.8	0%	73.0%	27.0%
2018	49	46	44	85.7%	$9,797.8	$43,039.8	2.2%	71.7%	26.1%
2019	58	56	49	89.8%	$11,916.3	$88,311.2	0%	75.0%	25.0%
Total	241	216	188	84.5%	$43,812.2	$206,313.5	6.5%	76.9%	16.7%

Panel B. SPAC characteristics

	Mean	Median	Minimum	Maximum	N
Offering proceeds ($mil)	$196.5	$175.0	$16.5	$900.0	216
Unit price ($)	$9.89	$10.00	$5.00	$10.00	216
Warrants per unit (208 units w/warrant)	0.74	1.00	0.25	1.00	208
Warrant strike price ($)	$10.78	$11.50	$5.00	$12.50	208
Maximum months allowed for acquisition	22	24	18	27	216
% of offering proceeds in trust	100.5%	100.0%	99.5%	105.5%	216
Gross underwriter discount	5.6%	5.5%	0.0%	7.5%	216

C. Liquidity and Volatility

We begin with basic attributes of the new SPAC market. A market is a place where buyers and sellers meet, and the demands of each determine the trading price. Market price does not exist in a vacuum—it is the product of an ongoing dialogue between would-be buyers and would-be sellers. So, a chief function of any market is the liquidity it provides—higher volumes of buying and selling create a more liquid market, and a more reliable market price.

SPACs begin their life trading as empty shells with a $10 liquidation value. Because the stock market is a market in information, we would not expect to see much trading in the absence of new information. So, in examining key features of the SPAC market, we begin with the information content and liquidity of the common stock of our sample of SPACs. These two concepts will allow us to better understand the nature of the market for SPACs by allowing us to see when the SPAC begins to exhibit characteristics similar to those of firms with actual assets—that is, when it becomes a plausibly functional, if indirect, market for the private company that it proposes to acquire. Said differently, SPACs trade on the public markets alongside typical operating companies, yet for quite some time their stock is not comparable to an operating company, and accordingly exhibits an unusual degree of illiquidity.

Conceptually, liquidity is related to the expense of immediately selling an asset. Thus, an asset is increasing in liquidity as the cost of selling falls. Indeed, the ability to buy and sell securities with minimal transaction costs is an important characteristic of an efficient market. Think of trading volume as a blunt measure of liquidity. When we standardize volume by the number of shares outstanding, which is "turnover," it becomes a reasonable measure of a firm's liquidity that can be compared across firms.

We also measure the price movement of the SPAC unrelated to overall market movements. Our measure, idiosyncratic volatility, is defined as the standard deviation of the residuals from a regression in which the dependent variable is the daily return for the SPAC and the independent variable is the CRSP equal-weighted index. We use this measure to proxy for the information content of stock prices.[188] Alternatively, one can also interpret this measure as merely the risk of the firm that is not related to market risk.

[188] Artyom Durnev et al., *Does Greater Firm-Specific Return Variation Mean More or Less Informed Stock Pricing?*, 41 J. ACCT. RSCH. 797 (2003).

Table 2. Turnover and Idiosyncratic Volatility

This table presents mean values and with the number of observations reported underneath. *Turnover* is daily trading volume scaled by the number of shares outstanding. *Idiosyncratic volatility* is the standard deviation of the residuals from a regression in which the dependent variable is the daily return for the SPAC and the independent variable is the CRSP equal-weighted index. Columns (1) and (2) provide values measured days -100 to -1 and days 1 to 100, respectively, relative to the acquisition announcement day. Columns (3) and (4) provide values measured days -100 to -1 and days 1 to 100, respectively, relative to the effective date – the deSPAC date. *** represents a 1% level of significance from a t-test for difference in means between the current mean and the mean in the previous column.

	Announcement Day = 0		Effective Day = 0	
	(1)	(2)	(3)	(4)
	-100 to -1	+1 to +100	-100 to -1	+1 to +100
Turnover	0.242%	2.086%***	1.905%	1.914%
	198	200	179	165
Idiosyncratic Volatility	.0336	.0371	.0342	.0621***
	202	205	185	182

Table 2 provides information about turnover (our measure of liquidity) and idiosyncratic volatility (our measure for price informativeness) of SPAC shares from the 100 days prior to the acquisition announcement until 100 days after the de-SPAC. Each column in the table is compared to the one immediately preceding it and the means are tested to see whether they are different from each other. The asterisks *** represent difference at the 1% levels. In this way, we can tell when during the SPAC process that the SPAC experiences changes in these two characteristics associated with publicly traded securities.

There are two main takeaways from the results in Table 2. First, SPAC liquidity, on average, significantly increases immediately after the acquisition announcement. Turnover increases tenfold from the days prior to the acquisition announcement to the days after the announcement. Moreover, liquidity neither increases after the de-SPAC nor falls significantly in the interim between the announcement and deSPAC. That is, the increase in liquidity associated with moving the private target to a public exchange effectively begins with the announcement of the deal. In liquidity terms, the SPAC market truly begins with the announcement of the target. But in informativeness terms—that is, the extent to which the price reflects all publicly available information, the existence of the floor means that idiosyncratic volatility—that is, unfettered price reaction to information—does not begin until the deSPAC.

The second takeaway from Table 2, is that there is no significant change in the informativeness of *prices* until after the de-SPAC. That is, prices do not reflect the change in liquidity, for an obvious reason: the redemption right provides an implicit floor and bolsters the stock price to secure it at around the $10 level. Prior to the de-SPAC, with its attendant redemption event, the idiosyncratic volatility does not significantly change from before the acquisition announcement to the period before the de-SPAC. The large jump in idiosyncratic volatility from .0342 prior to the de-SPAC to .0621 after the de-SPAC is consistent with both more information being released about the target once it has shed the shell of the SPAC and the new absence of an implicit floor to the stock price.

In sum, the data reflect common-sense intuitions. The results provided in Table 2 are

consistent with the market trading the SPAC stock in greater volume once news about its potential target is released. Yet, the information associated with the target is not impounded in the stock price until after the de-SPAC—likely because of the artificial floor that the redemption right creates. The SPAC market begins, in the sense of the volume of shares traded, after the SPAC announces its target. That new information sparks an increase in trading, but the price is not a complete indicator of information until after the deSPAC removes the artificial $10 floor.

So far, this Article has argued that SPACs create a revolutionary market in information about a still-private firm. By eliminating the delay between disclosure and trading, the market can give a species of near real-time feedback on the information that the SPAC discloses about the still-private target. The market mechanism is not perfect, however. Given that the chance to redeem shares accompanies the de-SPAC vote, there is a presumptive floor (usually of $10, the typical redemption price). That is, even if the market disfavors a proposed deal, the SPAC price may not reflect that disapproval because of the artificial $10 floor.[189] Table 2 demonstrates that this artificial floor results in a masking of the true volatility of the stock, because it masks the market price of the stock.

A stark example of how negative information is not impounded in the value of SPAC shares is the case of Kismet Acquisition Two Corp. This SPAC is controlled by a Russian oligarch. On the invasion of Ukraine by Russian forces, the shares of the SPAC held fast at $9.73 even though volume on that day was 1,692% of the 10-day volume average. This example is illustrative of the problem of suggesting that the SPAC creates a market for information in a still-private firm. The market more properly is a market for *positive* information on the still-private firm. This one-sided information problem then creates the potential for investors who hold beyond the de-SPAC to be subject to potential overpricing—a well-known problem in the acquisition literature. The next Section examines investors' returns in this truncated market.

D. The SPAC Market: Returns to Investors

Despite their limitations, SPACs do provide a way for the market to register, at least on the upside, its reaction to a new company proposing to enter the public markets. This is a species of price disclosure, although in truncated form. It allows us to see *under*valuation—and DWAC presented an extreme version of this undervaluation, as the stock rocketed up from $10 to $94. But if the market is unimpressed with a proposed target, the SPAC value will register neither that lack of enthusiasm nor its intensity.

Table 3 provides some insight into price reactions to the announcement of a transaction and the return on the date of the de-SPAC (the effective date of the acquisition). On the day of the announcement (Day 0), investors in the SPAC react significantly positively to the information provided about the target firm. The SPAC increase in value by, on average 3.2%, though the median is much lower at 0.4%, it is still statistically significant. One is tempted to compare this return to that of the initial trading day of an IPO. However, the price is still supported by the fact that shareholders can redeem their shares at the pre-specified price, thereby effectively muting any negative information about the still-private target.

[189] SPACs do trade below $10 per share, but usually much below because of the redemption value.

Moreover, the amount of information available at the time of the acquisition announcement is less than that available to the market on the first day of trading in an IPO. The effective date and the day after are the first time the stock is traded with no redemption back-stop. The day after the effective date, we observe a statistically significant average return of -1.8%. On the whole, then, it is not clear from the announcement-return data how the market responds, in total, to information about the target. Thus, we turn to premiums to see how well SPACs perform for their investors.

We compute the price premium over the promised redemption amount given at the time of the SPAC IPO. By the day after the acquisition announcement, SPACs, on average, are trading above the trust amount by about a 6% premium. At the effective date, this premium is, on average, 17.1% while the median is considerably less at 4%. A few cautions are in order, however. First, keep in mind that the premium at the effective date only reflects those targets that completed a de-SPAC, so these values should not be understood as measuring performance of SPACs as a class, but merely as an indication of the target firm's pricing in relation to the redemption amount.

Second, the evidence in Panel A of Table 3 suggests that the SPAC process provides a means for firms to go public in ways that, *on average*, do not harm shareholders. As in traditional IPOs, there are epic failures, but the evidence in this panel does not suggest a negative description for the form as a whole. However, our data show that focusing on *averages* risks obscuring the reality that there are some highly successful SPACs, and that these few big wins can cloak many offerings' tepid or negative returns.

Table 3. Abnormal returns and premiums around the acquisition announcement and the de-SPAC

In panels A and C, means are the unbracketed first number in each cell, bracketed numbers are medians, and the bottom number in each cell is the number of observations. *Abnormal return* is the daily return of the stock minus the CRSP equal-weighted index return on the same date. *Premium* is the stock price (at whatever date is being measured) scaled by the product of the trust amount (as a percentage of the proceeds from the IPO) and the share price of common stock at the IPO (usually, $10.00). Panel A presents abnormal returns and premiums of the three days including (in the first three columns) the acquisition announcement day and (for the last three columns) the effective date. Premiums are presented in Panel B in rows relative to trading days after the effective date. In Panel C, the redemption rate (*R*) is defined as all shares redeemed leading up to, and including, the vote date scaled by the number of redeemable and non-redeemable shares outstanding as of the 10-Q or 10-K immediately after the IPO date. The three rows represent, from top to bottom, the quartiles containing the highest, middle two, and lowest redemption rate quartiles, respectively. In the last column of Panel C, *Turnover* is defined in the caption of Table 2 and is measure as of the 100 days prior to the effective date. In the bottom, right-hand cell, *** represents a 1% level of significance from a t-test for difference in means between the current mean and the mean in the previous row.

Panel A. Abnormal returns and premiums around the acquisition announcement and effective dates

	Announcement Day = 0			Effective Day = 0		
	-1	0	1	-1	0	1
Abnormal Return	-0.2% [-0.0%] 204	3.2%*** [0.4%]*** 203	0.6% [0.1%] 203	0.9% [0.0%] 182	0.6% [-0.3%] 180	-1.8%* [-0.7%] 179
Premium	2.2%*** [0.9%]*** 204	5.9%*** [1.6%]*** 203	6.5%*** [1.7%]*** 204	19.3%*** [3.4%]*** 182	18.9%*** [3.1%]*** 180	17.1%*** [4.0%]** 181

Panel B. Premiums in the days after the de-SPAC

Day 0 = Effective Date	Mean	25th	Median	75th	N
+5	11.3%**	-15.9%	-1.3%	20.2%	180
+10	16.7%*	-20.0%	-3.8%**	24.4%	180
+15	17.6%**	-20.0%	-2.6%	26.5%	180
+20	17.9%**	-21.6%	-1.2%	28.5%	181

Panel C. Premiums in the days after the de-SPAC in relation to redemption quartiles

Redemption Rate (*R*)	0	+5	+10	+15	+20	Turnover -100 to -1
$R > 89.4\%$	3.9% [-1.2%] 44	-13.8%** [-15.2%]*** 44	-15.0%** [-20.2%]*** 44	-12.3% [-20.6%]*** 44	0.3% [-24.0%]*** 45	0.745% 43
$2.5\% \geq R \leq 89.4\%$	7.5%* [1.0%] 87	6.7% [-3.4%]** 87	18.5% [-5.9%]*** 87	18.4% [-3.2%]* 87	14.3% [-2.5%]* 87	1.473% 88
$R < 2.5\%$	58.6%*** [36.1%]*** 44	47.4%*** [30.3%]*** 44	46.9%*** [30.6%]*** 44	48.5%*** [34.2%]*** 44	46.1%*** [36.6%]*** 44	4.018%*** 44

Panel C of Table 3 provides a more nuanced view of the success of SPACs that execute an acquisition. In this panel, we examine premiums in the four weeks (twenty trading days) after the de-SPAC. While Panel A supported the view that, on average, de-SPACs provide a premium over the redemption amount, in reality the majority of de-SPACs provide no such success. The median premium is never positive in the period we examine and is significantly negative on the tenth trading day after the effective date. Thus, Panel B shows that although there are big gains above the redemption price, the majority of SPACs simply fail to provide shareholders a return better than the rates provided on government securities.

So far, these data do not make a compelling case for the SPAC market's value to retail investors. Although on average, retail investors do not lose money on SPACs that complete a merger, outsized gains by a few mask large losses on the part of many.

Our companion piece argued that the current SPAC market is fundamentally flawed because it allows for deals to move forward even if the majority of shareholders redeem their shares.[190] We found a negative relationship between redemption rates and premiums. That is, firms where more shareholders redeemed shares at the de-SPAC did significantly worse than those where most SPAC shareholders remained with the firm.

We reexamine this relation of redemption rates and stock premiums over the trust amount in light of the above mean/median discrepancy by splitting the premium results into quartiles—that is, we order SPACs by redemption rate and divide the sample by four. We then compare the performance of the lowest redemption quartile, the two middle quartiles, and the highest redemption quartile.

Panel C lists our results. The only quartile that is both positive and significantly different from zero is the quartile with the lowest redemption rates—a rate of less than 2.5% of all redeemable shares outstanding after the SPAC IPO. To be clear, in this subgroup of SPACs, 97.5% of SPAC shareholders held their shares through the de-SPAC because (presumably) they believed in the value of the operating firm being acquired. This subset of firms has mean (median) premiums of well over 40% (30%) for each of the trading days after the de-SPAC examined. Thus, this upper-echelon tier of SPACs show extremely good returns for the SPAC shareholders lucky or savvy enough to participate in them. In this upper quartile of cases, hardly any stockholders redeem, and they all enjoy significant positive returns, at a median rate of 30%, four weeks after the de-SPAC.

In contrast to this upper quartile of low-redemption/high-return SPACs, the highest redemption quartile perform miserably. This quartile features SPACs with sky-high redemption rates, north of 89.4%. Again, to be clear, in these SPACs, only 10.6% of SPAC shareholders opted to hold through the de-SPAC and to become shareholders of the subsequent operating company. The median return is significantly negative and hovers around -20%. Perhaps unsurprisingly, these are clearly terrible deals for the few SPAC shareholders who remained through the de-SPAC.

Perhaps surprisingly, the middle two quartiles also do not fare well. This range of SPACs

[190] Redeeming SPACs, forthcoming…

have redemption rates between 2.5% and 89.5%, and also have median returns that are both significant and negative—though much less negative than the lowest quartile, which is at about -3%. Thus, half of SPACs—the middle of the SPAC pack, if you will—experience significant negative returns, but not particularly large losses. The bottom quartile of redemptions and the top quartile of redemptions exhibit significant and large negative and positive returns for investors. In general, then, most SPACs are bad deals for investors, and the bottom quarter are quite bad. But the top quarter are good deals—and quite good.[191]

One further caution is in order: our sample's pricing in some cases necessarily involves data of dubious utility. If nearly all the SPAC's shareholders head for the exits, it stands to reason that liquidity will suffer, and extreme price swings can occur because of the lack of liquidity in newly de-SPAC'd companies where redemption rates were high. Organogenesis, which was bought by the Avista Healthcare SPAC, provides an example of the pricing problems of some of these SPACs. At the time of the de-SPAC, on December 10, 2018, the SPAC Avista had been delisted for over a month. Nineteen trading days after the de-SPAC, the stock, now newly christened Organogenesis, began trading again on NASDAQ at $13.44 per share.[192] However, on day +20, it traded at a 723% premium (a price of $82.35) to the redemption price. Yet, there were only about 28,000 shares traded on that day. The following day (January 9, 2019), the price rose to $148.85—but on a volume of only 4,380 shares. One month later, the price was $9.21, and by March it was trading in the $7.00–$8.00 range, a discount of 20% to 30% of the redemption value. Indeed, prices for many of the SPACs with high redemption rates are somewhat anomalous.

We briefly examine what might be causing these large swings in price in the last column of Table 3, Panel C, where we examine turnover by redemption quartile. Our results show a significant difference between the liquidity of both the highest, and middle two, redemption quartiles and the lowest redemption quartile. The turnover of the lowest redemption quartile (4.018%) is more than four times the amount in the highest quartile (0.745%) and over twice the amount of the middle two quartiles (1.473%).

For purposes of assessing the application of an actual redemption threshold, we present more general redemption breakpoints in Table 4. We examine premiums and liquidity for redemption thresholds of 25% and 75%. These results support those found in Panel C of Table 3 and provide some additional texture to the distribution of SPACs with respect to actual redemption rates. Well over a third of our sample exhibit redemption rates below 25%. For those SPACs with redemption rates less than 25% we observe both large mean (32%) and median (15%) premiums and significantly greater liquidity prior to the effective date. Conversely, premiums for SPACs with redemption rates 25% and higher are not positive, and these SPACs experience significantly lower liquidity than SPACs with redemption rates below 25%.

[191] For both the lowest and middle two quartiles mean returns are only significant when they are negative, but are usually not different from zero. Again, this finding demonstrates the perils of relying on averages instead of medians. The outliers in these two groups are massive.

[192] As can be seen from the increase in sample size from day +15 to day +20 of one observation (44 to 45), Organogeneis reenters our sample at this point.

Table 4. Premiums and liquidity for broad redemption rates

Means are the unbracketed first number in each cell, bracketed numbers are medians, and the bottom number in each cell is the number of observations. *Premium +10* is the closing stock price at the tenth day after the effective date scaled by the product of the trust amount (as a percentage of the proceeds from the IPO) and the share price of common stock at the IPO (usually, $10.00). *R* is the redemption rate defined as all shares redeemed leading up to, and including, the vote date scaled by the number of redeemable and non-redeemable shares outstanding as of the 10-Q or 10-K immediately after the IPO date. In the last column, *Turnover* is defined in the caption of Table 2 and is measured as of the 100 days prior to the effective date. In the bottom, right-hand cell, *** represents a 1% level of significance from a t-test for difference in means between the current mean and the mean in the previous row.

Redemption Rate (*R*)	Premium +10	Turnover -100 to -1
$R > 75\%$	-15.7%*** [-18.4%]*** 65	0.786% 65
$25\% \geq R \leq 75\%$	43.7% [-4.8%]*** 44	1.480% 45
$R < 25\%$	32.0%*** [14.8%]*** 66	3.396%*** 65

Overall, we believe these results demonstrate that the benefits of the new SPAC market could be considerable, but only for a subset of SPACs. SPACs with low redemption rates, and whose management could get shares distributed into the hands of a sufficiently large number of shareholders, exhibit return and liquidity characteristics that approach a traditional IPO. And these SPAC shareholders can enjoy sizeable returns, with a median just north of 36% on the first day of de-SPAC. For those unlucky SPAC shareholders that hold through a de-SPAC with high or even average redemption rates, the picture is much bleaker.

Armed with the insights on the SPAC market from these empirical results, we can now step back and return to the basic problem that SPACs attempt to solve: how to bring a company public outside the confines of a traditional IPO. Remember the key question in a stock's debut relates to pricing: inevitably, a company's worth on the market is axiomatically unknown before it actually trades on the market. SPACs allow for a unique period of public price discovery—a dialogue, if you will, between the markets and the target, which receives instantaneous feedback on its disclosures of information.

If we look past averages, where outliers skew the results, the data show that the current SPAC market offers poor returns to shareholders. Indeed, we argue that the current SPAC market is untenably bad for shareholders. But a more granular look at the data reveal that one section of the SPAC market does remarkably well for SPAC shareholders: those who hold in SPACs with low redemption rates.

The implications of these results are profound. If SPACs offer a market-pricing mechanism that is less dependent on the underwriting banks as an intermediary, then our results reveal that SPACs' alternative market test—if properly understood to consider redemption rates—works.

The market, despite concerns about investor hysteria and asymmetric information, appears to reliably predict good companies. With this in mind, the next Part moves to a normative recommendation and some additional considerations given these empirical results.

VI. REFORMING THE SPAC MARKET

The main contribution of this Article has been to point out the real stakes of the SPAC debate. Questions as to whether to allow forward-looking statements or to impose Section 11 liability are valid, but also almost beside the point. The essential question for SPACs is whether they should exist at all—and stripped of the regulatory arbitrage points, the question becomes whether we should have a mechanism that bypasses the enforced delay between disclosure and trading that the '33 Act imposes. We believe that this market should exist, and we use this Section to make the case as to why.

A. The Threshold Questions: Reform of the Redemption Right & Rollback of Section 11 Liability

Part V demonstrates the urgent need for reforming the redemption right. Our companion piece treated this subject in depth, and argued for a 50% redemption ceiling, meaning that if more than 50% of SPAC shareholders redeem, the deal should not go forward. The data we present here make that case at a more granular level, and even suggest that a higher redemption threshold would be better. After all, the top quartile features significant returns to SPAC shareholders at a rate roughly comparable to the first-day IPO pop.

While acknowledging these data, we are mindful of the lessons of the early generation of SPACs. These typically featured a conversion threshold of 80%, meaning that if more than 20% of SPAC shareholders redeemed their shares, the deal would not go forward.[193] This requirement gave rise to a practice of greenmailing, whereby certain shareholders would buy SPAC shares and threaten to redeem unless given special favors.[194] The data suggest that imposing a 75% redemption limit (either by way of direct requirement or by disallowing the current practice whereby shareholders can vote for the merger while simultaneously exiting) would protect shareholders from the majority of bad deals, without risking a holdup right.[195]

By the same token, our data demonstrate that a high redemption threshold provides enough protection for investors and the markets alike. Investors who participate in the SPAC market have a protection unavailable to most other investors: the comfort of a guaranteed return. Companies can go bankrupt and most shares can become worthless overnight. But SPAC shareholders have recourse to the trust account. Our data show that redemptions can act as a brake on bad deals, and that those that go forward with only around 30% redemption levels or less generally offer excellent returns—approaching IPO first-day levels—for SPAC

[193] Usha R. Rodrigues & Michael Stegemoller, *Exit, Voice & Reputation: The Evolution of SPACs*, 37 DEL. J. CORP. L. 849 (2012).

[194] *Id.* at 857.

[195] It may be that another percentage between 50 and 80 would screen out more bad deals without increasing the holdup risk unduly, but such nuances are beyond the scope of this Article.

shareholders.

But the SEC's proposed imposition of Section 11 liability on the de-SPAC will kill even these value-increasing deals. If banks are subject to this same level of liability, then they will prefer an IPO over a de-SPAC. From the target company perspective, if a bank subjects a de-SPAC to the same level of due diligence as it does an IPO, then the IPO is the more attractive choice. A de-SPAC, if coupled with a low conversion threshold, introduces contingency. A target cannot be certain that the deal will close until the redemption date is passed. Given that uncertainty, most companies will likely opt for an IPO.

Moreover, imposition of this liability misconstrues the role of investment banks in the de-SPAC. Banks simply do not function as underwriters in the de-SPAC in traditional IPOs. If anything, the sponsors are the underwriters in a de-SPAC. The SEC's proposed rules may force banks to serve as underwriters in the de-SPAC—but there appears to be little incentive for banks to take on this role. More than likely, they will abandon the field entirely, as many have already done.

Thus, given the data on redemptions, we advocate for not imposing Section 11 liability at the de-SPAC stage. We support other measures requiring increased disclosure and the restriction of forward-looking statements during the de-SPAC. But our data show that redemption levels can serve as a check on the worst deals, if only regulators were to impose real limits.

B. The Potential Benefits and Essential Risk of the SPAC Market

Presuming that reform can impose a redemption threshold on SPACs and avoid imposition of Section 11 liability at the de-SPAC, we argue that SPACs can serve a useful function to both the investor and the target company—but we also highlight the categorical change in risk to investors that the SPACs market represents.

SPACs let the public in earlier, in three senses. First, SPACs have been lauded as a fundraising vehicle for early-stage companies—especially those that need large influxes of capital, like space exploration or electric vehicle companies—that may not receive funding through traditional venture capital. Second, SPACs allow average investors access to the IPO, rather than having the underwriting syndicate allocate shares to favored, moneyed clients. Third, SPACs allow average investors access to pre-IPO information markets in a way that conventional IPOs cannot do.

1. Democratizing Access to Capital

Our data show that a subset of successful firms chose SPACs over the traditional IPO, VC funding, or other mechanisms for obtaining capital. For this subset of firms, SPAC financing was attractive and a good bet—for investors as well as for the target company.

The reason for this choice is not entirely clear to us. The popular press has focused on the

fact that companies like electrical-vehicle or space-exploration companies, which require billions in initial capital investment, have found SPACs to be a viable alternative source of capital when venture funds are more reluctant.[196] Venture investment is crucial to most technology startups. Particularly in Silicon Valley, by the time a company is ready for an IPO, it has gone through rounds of venture-capital investment.[197] But VC funds typically have a 10-year investment timeframe and conventionally are wary of investments requiring large amounts of startup capital, so these capital-intensive firms steering towards SPACs may not have access to typical VC financing.

But companies' reasons for using SPACs—especially those of our top quartile of SPACs—are irrelevant for our purposes. What matters is that a subset of firms chose SPACs over other fundraising choices, and were successful for themselves and for investors. We believe that preserving this substitute to the more traditional methods of fundraising to be a benefit to entrepreneurs.

2. Democratizing Investing

By the same token, SPACs have increased the public's access to early-stage companies. Investment in venture-capital funds is limited to institutional investors and wealthy individuals, and retail investors can only participate indirectly through mutual funds or pension funds.[198] Thus, for the most part, investing in early-stage companies is the preserve of the wealthy. Thus, the SPAC can serve as the "poor man's private equity," democratizing access to capital by allowing the public to invest in companies that are at an earlier stage than those that typically come to market. Our data suggest that some of these investors—those who hold the SPACs with the lowest quartile of redemption rates—do very well.

The counterargument to this narrative is twofold—first, venture capital is a risky business, where the investors' capital is tied up for ten years or more. In exchange, venture investors expect a sizable return. Venture funds invest in a portfolio of companies, of which many—perhaps most—will not make much of a profit. Venture funds often rely on a handful of "home run" investments to balance the many companies that will either fail or not produce much of a return. While a retail investor in theory can create a portfolio of SPACs, there is no evidence to suggest that investors are actually doing so.

Moreover, while it is tempting to spin the exclusion of retail investors from early-stage investments as an example of the "rich getting richer," such narratives are over-simplifications. For one thing, retail investors can find some exposure to these kinds of investments via pension funds and mutual funds. For another, venture capital returns have trailed major indices—because they are risky investments. And this point brings us to a final, central consideration in assessing the benefits of the SPAC market.

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[196] *See, e.g.*, Heather Somerville & Eliot Brown, *SPAC Startups Made Lofty Promises. They Aren't Working Out.*, WALL ST. J. (Feb. 25, 2022, 5:02 PM), https://www.wsj.com/articles/spac-startups-made-lofty-promises-they-arent-working-out-11645785031?mod=Searchresults_pos4&page=1.

[197] *Venture Capital Investment Stages*, STARTUP.LAW (Feb. 2, 2018), https://startup.law/venture-capital-investment-stages/.

[198] Bob Zider, *How Venture Capital Works*, 1998 HARV. BUS. REV. 131 (1998).

3. Retail Exposure to the Vagaries of the Market

The pandemic saw the rise of so-called meme stocks. GameStop, a prominent example of meme-stock, hit a low of $2.57 in December of 2020. The next month, in a frenzy fed by Reddit forums like WallStreetBets, the stock traded to a high of $380.[199] AMC holdings similarly spiked from a low of $1.91 to a high of $76.62 in 2021.[200] Retail investors were investing directly, exposing themselves to considerable risks, relying on Reddit and other online fora for investment advice, and pushing each other to send favored stocks "to the moon."[201]

Meme-stock trading triggered much consternation, SEC investigations, and Congressional hearings.[202] Some investors made life-altering sums of money, allowing them to pay off student-loan debts.[203] Others have lost their life savings.[204]

GameStop, AMC, and Hertz are all examples of public investors making and losing money rapidly. Considerable sums of money. But of course, they could have lost life savings in a non-meme stock as well. Any stock which is traded on the NYSE or NASDAQ, as nearly all SPACs have been in the past few years, is subject to the risk of sudden swings in price. Joe Public could always lose his shirt in the public markets. The meme-stock phenomenon just accentuates the risk that ordinary investors always face in the public markets by sharpening the swings up and down, increasing the risk that an unwary investor will get swept up (or strike it rich).

We can use meme stocks as both shorthand and metaphor: SPACs expose the public to the risk of buying public shares—to the risk of stocks memeing—when they have far less information than is typical. Again, DWAC is a good example. Indeed, many commentators referred to DWAC as a "meme stock."[205] The meme-stock phenomenon casts in sharp relief the risks posed by letting the public in early, in the main sense that this article has outlined.

AMC and GameStop were mature public companies when they became meme stocks. Even though retail investors—and short sellers—could lose money when they became meme stocks, both companies had been vetted through the traditional IPO process and they had a history of '34 Act disclosures stretching back years. As we have seen, in SPACs, information on the target trickles out over time. A companion piece describes how illiquidity can accompany

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[199] Gunjan Banerji, Juliet Chung & Caitlin McCabe, *GameStop Mania Reveals Power Shift on Wall Street – and the Pros Are Reeling*, WALL ST. J. (Jan. 27, 2021, 6:46 PM), https://www.wsj.com/articles/gamestop-mania-reveals-power-shift-on-wall-streetand-the-pros-are-reeling-11611774663?mod=article_inline.

[200] Sarah Whitten, *How AMC Rode the Meme Stock Rally to Revitalize Its Business*, CNCBC (Jan. 26, 2022, 11:58 AM), https://www.cnbc.com/2022/01/26/how-amc-rode-the-meme-stock-rally-to-revitalize-its-business.html.

[201] Quibble_, *We Still Sending $AMC to the Moon?*, REDDIT (Feb. 3, 2021), https://www.reddit.com/r/wallstreetbets/comments/lc77th/we_still_sending_amc_to_the_moon/.

[202] Connor Smith, *Congress Holds Hearing on Meme Stock Volatility. GameStop Stock Had a Very Quiet Day.*, BARRON'S (Mar. 17, 2021, 6:25 PM), https://www.barrons.com/articles/congress-holds-hearing-on-meme-stock-volatility-gamestop-stock-had-a-very-quiet-day-51616019915.

[203] Banerji et al., *supra* note 196.

[204] Drew Harwell, *As GameStop Stock Crumbles, Newbie Traders Reckon with Heavy Losses*, WASH. POST (Feb. 2, 2021), https://www.washingtonpost.com/technology/2021/02/02/gamestop-stock-plunge-losers/.

[205] Faizan Farooque, *DWAC Is the Meme Stock Phenomenon No One Saw Coming*, YAHOO (Dec. 27, 2021), https://www.yahoo.com/video/dwac-meme-stock-phenomenon-no-160817885.html.

this market.[206] SPACs present the risk of meme-ing against a backdrop of asymmetric information.

Stepping back, we can see that SPACs present the newest and perhaps most pointed example of pressure on the dividing line separating public and private companies. The '33 Act endeavored to hold fast the distinction between private companies, which enjoy looser disclosure rules but can only sell to certain investors, and public companies, which face more onerous disclosure obligations but in return can sell to anyone.

Donald C. Langevoort and Robert B. Thompson have written on the tension inherent in this divide,[207] as has Hillary Sale.[208] Inevitably, perhaps, companies seek to evade burdens of regulation while simultaneously accessing the public markets. The question that policymakers need to confront is whether the benefits from creating via SPACs a market-pricing mechanism, of a sort, is worth destabilizing the distinction between public and private further, and exposing retail investors to new risks.

We close by recommending two alternatives. We have made the case in this Article that the SPAC market is different in kind from the traditional stock market: it exposes investors to new risks, including information asymmetries and liquidity challenges. We should acknowledge those differences in concrete ways. First, we could require that transactions in SPACs disclose their idiosyncratic risks. Brokers who recommend penny stocks must both provide a standardized disclosure of the risks to investors and wait for a signed acknowledgement of the risks from them before allowing a trade. The details of the mechanism do not matter as much as the need for a signal to a SPAC investor that although she is buying shares nominally listed on a national exchange, different disclosure rules and a different sort of liquidity await her. This tailored disclosure could also make clear the importance of the redemption decision; our companion piece emphasizes our concern that retail investors do not appreciate the importance of the redemption question.[209]

Alternatively, we could impose some additional requirements on investors before allowing them to trade SPACs. We can look to option-trading requirements as an analog. Before trading options, investors must be approved by their broker. They must answer questions regarding their investment objectives, trading experience, and personal financial information.[210] After assessing this information, the brokerage firm will determine what level of option-trading levels the investor qualifies for, ranging from relatively simple puts and calls to more esoteric iron butterflies and iron condors.[211] Investors must also receive the Options Clearing Corporation publication, "Characteristics and Risks of Standardized Options," which explains options and

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[206] Forthcoming…

[207] Donald C. Langevoort & Robert B. Thompson, *"Publicness" in Contemporary Securities Regulation after the JOBS Act*, 101 GEO. L.J. 337, 340 (2013); Robert B. Thompson & Donald C. Langevoort, *Redrawing the Public-Private Boundaries in Entrepreneurial Capital Raising*, 98 CORNELL L. REV. 1573, 1575 (2013).

[208] Hillary A. Sale, *The New "Public" Corporation*, 74 LAW & CONTEMP. PROBS. 137, 138-41 (2011).

[209] Rodrigues & Stegemoller, *Redeeming SPACs*, *supra* note 160.

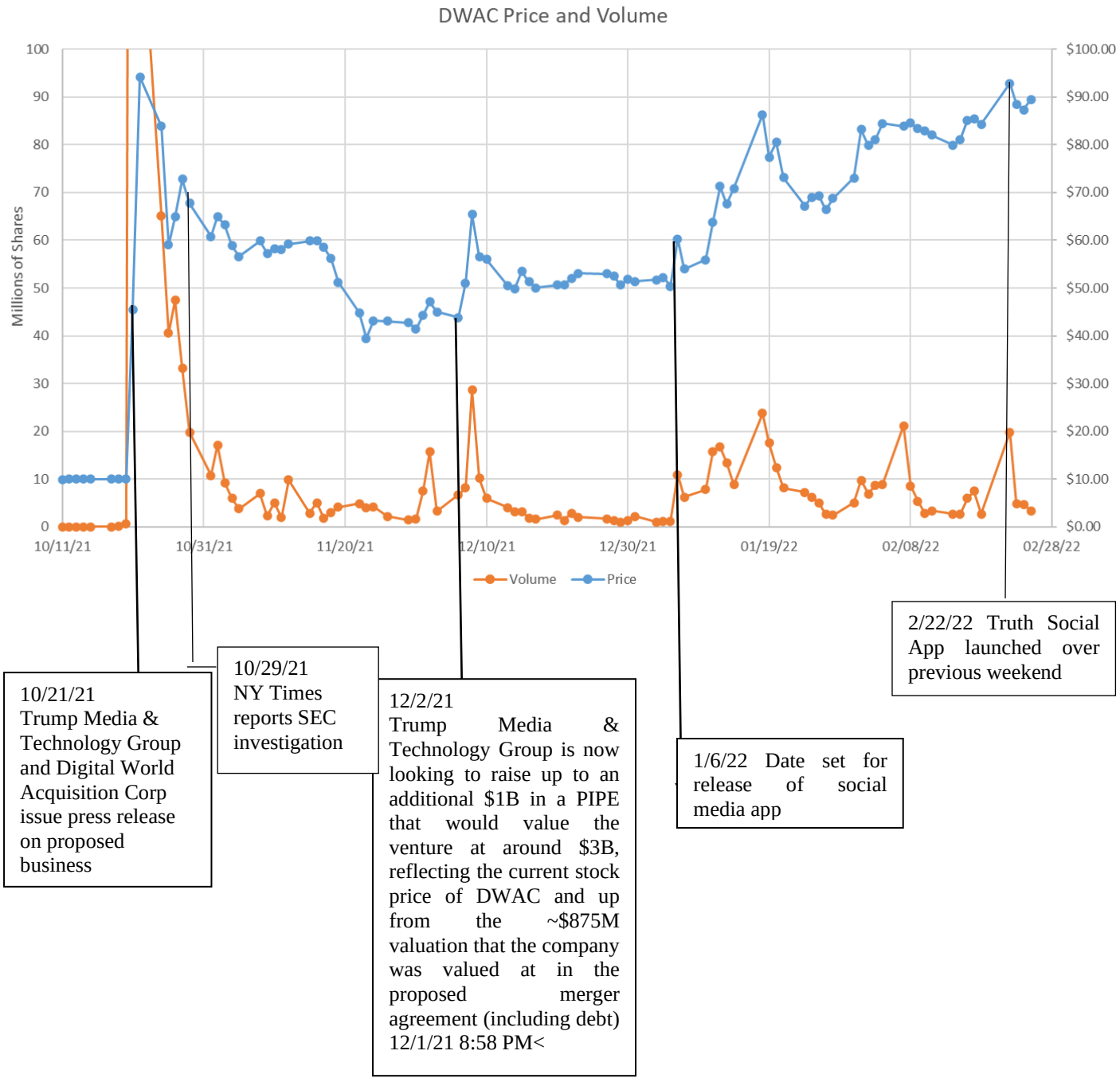
[210] *Investor Bulletin: Opening an Options Account*, U.S. SEC. & EXCH. COMM'N (March 18, 2015), https://www.sec.gov/oiea/investor-alerts-bulletins/ib_openingoptionsaccount.html [hereinafter *Investor Bulletin*].

[211] Lee Stanton, *How to Get Approved for Options in Robinhood*, ALPHR (March 5, 2021), https://www.alphr.com/get-approved-options-robinhood/.

describes their risks.[212] Given the perils of asymmetric information, illiquidity, and the need to be wary during redemption, a similar requirement of sophistication or experience might limit the number of unsophisticated investors who purchase SPACs and ensure some level of disclosure and knowledge in those that do purchase them.

[212] *Investor Bulletin*, *supra* note 206.

Exhibit 1


DWAC Price and Volume
Millions of Shares
100
90
80
70
60
50
40
30
20
10
0
$100.00
$90.00
$80.00
$70.00
$60.00
$50.00
$40.00
$30.00
$20.00
$10.00
$0.00
10/11/21
10/31/21
11/20/21
12/10/21
12/30/21
01/19/22
02/08/22
02/28/22
Volume
Price
10/21/21 Trump Media & Technology Group and Digital World Acquisition Corp issue press release on proposed business
10/29/21 NY Times reports SEC investigation
12/2/21 Trump Media & Technology Group is now looking to raise up to an additional $1B in a PIPE that would value the venture at around $3B, reflecting the current stock price of DWAC and up from the ~$875M valuation that the company was valued at in the proposed merger agreement (including debt) 12/1/21 8:58 PM<
1/6/22 Date set for release of social media app
2/22/22 Truth Social App launched over previous weekend